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In the matter of: :
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COMPULSORY LICENSE FOR MAKING :
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AND DISTRIBUTING PHONORECORDS; : CRT Docket No. 80-2
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ROYALTY ADJUSTMENT PROCEEDING :
 :
(MECHANICAL) :
 :
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2100 K Street, N.W.
Room 414
Washington, D.C.

Wednesday, July 23, 1980

The hearing in the above-entitled matter commenced
at 10:10 a.m., pursuant to notice.

BEFORE:

MARY LOU BURG, Chairman
THOMAS C. BRENNAN, Commissioner
DOUGLAS E. COULTER, Commissioner
CLARENCE L. JAMES, JR., Commissioner
FRANCES GARCIA, Commissioner

APPEARANCES:

ALVIN DEUTSCH, Attorney-at-Law
FREDERICK GREENMAN, JR., Attorney-at-Law
Counsel for AGAC

MORRIS B. ABRAM, Attorney-at-Law
RICHARD M. ZUCKERMAN, Attorney-at-Law
HELEN HERSHKOFF, Attorney-at-Law
Counsel for NMPA

JAMES F. FITZPATRICK, Attorney-at-Law
CARY H. SHERMAN, Attorney-at-Law
LOUIS COHEN, Attorney-at-Law
JILL B. DEAL, Attorney-at-Law
Counsel for RIAA

C O N T E N T SWITNESS:DirectCrossRedirectRecross

DAVID KISER

By Mr. Fitzpatrick

9

EXHIBITS:Identified

RIAA Exhibit BB

39

RIAA Exhibit EE

119

P R O C E E D I N G S

CHAIRMAN BURG: Good morning. We will proceed.

MR. FITZPATRICK: Madam Chairman, one housekeeping matter --

CHAIRMAN BURG: There always is.

MR. FITZPATRICK: Yes, I hope it will be short. This is -- you had indicated yesterday on page 5 of the transcript about our request for a Friday session. I can reply that right now for several reasons, we cannot and we will not meet on Friday; but we --

CHAIRMAN BURG: I am sorry, which Friday are you talking about?

MR. FITZPATRICK: This coming Friday. But we would be happy to meet on Monday if that would serve any useful purpose.

CHAIRMAN BURG: I think --

MR. FITZPATRICK: I understand that the following Friday, we are scheduled; and we would hope that that date could be kept open. For our part, we would hope that the cross examination could be and -- examination of the Tribunal could be conducted in a way that would permit a Monday meeting.

Now, I fully appreciate -- Mr. Abram has had on the record for some time that he has an SEC presentation on Monday, and if he is out of play that day, I would hope that

1 we could have an examination proceed in a fashion, in the
2 sequence that would permit us to have a Monday session. I
3 am not at all certain that can be done, but I think that
4 you had asked us. I had indicated that I would advise you
5 as to our willingness to meet on Monday, and we are quite
6 willing to meet on Monday, we would urge such a session
7 to permit us to finish up next week.

8 CHAIRMAN BURG: Mr. Abram?

9 MR. ABRAM: Madam Chairman, I stated yesterday
10 I have an appointment at the Securities and Exchange
11 Commission, and the preparation of that appointment is not
12 something that I can do anything about. And I do not want
13 to meet next Friday, but I will be happy to accomodate
14 the Commission's request, which you indicated you might
15 be able to effectuate, maybe next Friday.

16 MR. DEUTSCH: Madam Chairman, I might just add
17 that I have an arbitration next Monday, which was scheduled
18 four weeks ago, on the assumption that we would not be
19 meeting on Monday and Friday.

20 CHAIRMAN BURG: Let me say that throughout
21 these proceedings and every other proceeding we have been
22 involved in this spring and summer, we on the Tribunal have
23 tried to be as accomodating to the various parties that are
24 involved in these cases as we possibly can; we reserved
25 always the proviso that -- you know -- we are the boss.

1 And we will again accomodate you to the extent that Friday --
2 this Friday is obviously out, and Monday seems to be out,
3 so we will proceed on the basis that a week from Friday, we
4 will be in session. And so please adjust your schedules
5 accordingly.

6 I don't share Mr. Ftizpatrick, I hope, with
7 all my heart that you are correct that we will finish then,
8 but if indeed we do not on that Friday, we can go over into
9 that next week for whatever, a day or two days, it takes to --

10 MR. FITZPATRICK: It may be at least, if it
11 would be possible to flag the Monday following, it is our
12 earnest desire that at the earliest moment --

13 CHAIRMAN BURG: Let's just hold that Friday,
14 which I believe then will be August 1.

15 MR. FITZPATRICK: Right.

16 CHAIRMAN BURG: And that Monday would be the
17 fourth. Hold those two days open so that we can perhaps
18 wrap it up, with luck.

19 MR. FITZPATRICK: Well, I would anticipate that
20 we would clearly go through Friday of next week with the
21 remaining witnesses. We are assessing our situation in
22 terms of the remaining witnesses, in an attempt to have
23 only the witnesses come on now that are essential to our case.

24 CHAIRMAN BURG: Very good.

25 MR. FITZPATRICK: And we are ready to proceed.

1 CHAIRMAN BURG: Thank you very much.

2 MR. ABRAM: Madam Chairman, could I just ask
3 a question, please, to facilitate our preparation? I suppose
4 as has been indicated and understood, I think, there will
5 be final argument. But I don't assume that final argument
6 necessarily would take place immediately from the conclusion
7 of the record. It probably would be helpful.

8 CHAIRMAN BURG: An effort or something --

9 MR. ABRAM: And that can be scheduled at the
10 convenience of the Tribunal and the parties.

11 Thank you.

12 MR. FITZPATRICK: At the conclusion of our case,
13 I think it would be useful for us to have some colloquy for
14 schedule for filing findings, conclusions, and possibly
15 replies, and then schedule an oral argument. I would hope
16 that all of us might have the chance to take a deep breath
17 for at least a period of time at the conclusion of our case
18 before we are required to have findings in, and we will have
19 some suggestions to the Tribunal.

20 MR. CHAIRMAN: If by colloquy, Mr. Fitzpatrick,
21 you mean we will have a discussion, you are absolutely
22 correct. And --

23 MR. FITZPATRICK: If not a colloquy, we will
24 get our instructions.

25 CHAIRMAN BURG: And you will be able to take at

1 least a half a breath if not a complete deep breath.

2 Very good, let's --

3 MR. GREENMAN: Madam Chairman?

4 CHAIRMAN BURG: Yes, Mr. Greenman.

5 MR. GREENMAN: One, could we have tomorrow
6 the names of the witnesses that you wish to calling the week
7 thereafter so we are prepared to to follow?

8 MR. FITZPATRICK: Of course, I have been quite
9 religious about that on Thursdays.

10 CHAIRMAN BURG: Is tomorrow Thursday?

11 MR. GREENMAN: Now, secondly Madam Chairman,
12 there is an open item from the testimony of Ms. Cranston last
13 week. I just wanted to find out what was going to be done
14 with that. On, I think it was on the 17th, at pages 150
15 and 151, we were talking about that schedule derived from the
16 58 first recording releases and I had asked for a breakdown
17 of the figure for advances in recording costs and other
18 advances. And the witness said she would attempt to provide
19 it, and Commissioner Coulter asked also while she was doing
20 that if she could perhaps find out what portion of the
21 advances in recording costs were paid by the two artists
22 that received that recording. I wonder what the status of
23 that request is. Are we going to receive that?

24 MR. FITZPATRICK: We will inquire as soon as
25 we can, California time.

1 MR. GREENMAN: Could you let us know this
2 afternoon?

3 MR. FITZPATRICK: I will try.

4 CHAIRMAN BURG: Is that it?

5 MR. GREENMAN: Yes.

6 CHAIRMAN BURG: Thank you. Mr. Fitzpatrick?

7 MR. FITZPATRICK: Yes.

8 CHAIRMAN BURG: Proceed.

9 MR. FITZPATRICK: Yes. We had been speaking,
10 at the conclusion of the session yesterday, about the
11 effects of inflation on the copyright mechanical royalty
12 rate, and the questions of the comparison of the cost of
13 living index against the rate and against the measure of
14 income; and I believe that I just asked Dr. Kiser whether
15 he had compared actual mechanicals paid over a period of
16 time with the cost of living index.
17 Whereupon,

18 DAVID KISER

19 resumed as the witness and, still under oath, was
20 examined and testified as follows:

21 DIRECT EXAMINATION

22 BY MR. FITZPATRICK:

23 A Yes, I have.

24 Q Could you describe that analysis for us,
25 please?

1 A Well, what I have done in any analysis like
2 this, of course, is an issue of how you choose the base
3 year, and there has been a lot of attention in this hearing
4 to the period from 1955 forward. In addition, Mr. Nathan,
5 had in his study a consideration of mechanicals, and CPI
6 from 1955 forward; and I just plotted the two against each
7 other purely to show some historical perspective.

8 Here we have the CPI --

9 MR. ABRAM: Madam Chairman, is this the new
10 chart? It is not submitted in the economic data.

11 THE WITNESS: This is a chart that contains
12 the data that Dr. Nathan had in his submissions, yes.

13 MS. DEAL: Could you tell us which chart it is
14 referring to?

15 MR. FITZPATRICK: Yes, pages 37 and 38.
16 And also the cost of living index which was set forth in
17 both Dr. Nathan and Dr. Renfret's study. So this is, as
18 I understand it, a plotting of data that has been spread on
19 the record before.

20 MR. ABRAM: What chart number is this?

21 CHAIRMAN BURG: Y, Z is your next one.

22 MR. FITZPATRICK: Yes, this will be Z.

23 THE WITNESS: Well, I thought it was useful
24 to get some historical perspective, so looking from 1955 to
25 1979, consumer price index rising down here and copyright
mechanical royalties, as you can see, far and away exceeding

1 the consumer price index. Now, we use the total of
2 mechanical royalties in addition to the one which we discussed
3 yesterday, which was per released tune.

4 And we understand full well that the collectors'
5 of these royalties vary; there may be more publishers at a
6 certain time or less; there may be more songwriters at a
7 certain point, or fewer. But we don't have nay information
8 on that. So we simply want to look at the total and
9 demonstrate to you that the gap between the CPI and copyright
10 mechanical roaylties is a large one and in favor of mechanical
11 royalties.

12 CHAIRMAN BURG: Dr. Kiser, that is the total
13 amount of all mechanical royalties.

14 DR. KISER: That is right, based on all of the
15 figures that Mr. Nathan cited, in page 37. There are a
16 few missing values, and we extrapolated between those. I
17 would point out that there is no estimate here of foreign
18 mechanical royalties included in that, in this series here.

19 BY MR. FITZPATRICK:

20 Q All right, now, on the other side, have record
21 prices done as well against inflation?

22 A Recording company prices have trailed inflation
23 since the early 1960s as RIAA exhibit shows --

24 COMMISSIONER JAMES: Do I understand the first
25 chart is mechanical royalties in total dollars and the

1 second chart is present?

2 MR. FITZPATRICK: Yes, I haven't introduced this
3 yet.

4 COMMISSIONER JAMES: Could you explain that?

5 BY MR. FITZPATRICK:

6 Q Yes, Dr. Kiser, would you explain the chart,
7 Exhibit AA, please?

8 A Yes. What I have done here is track the consumer
9 price index starting back in 1955 at a base of 100. Ob-
10 viously it accelerates a little faster than in that chart,
11 because the scale is broader, and then overlaid upon that
12 the producer price index per record, which is recorded by
13 the Bureau of Labor Statistics on an annual basis.

14 And one can see that from 1955-1963 or so the
15 producer prices per record pretty much kept pace with the
16 consumer price index; and starting in around 1962 or '3,
17 there is a decided lagging of producer price index of phono-
18 graph records and pre-recorded tapes to the consumer price
19 index.

20 COMMISSIONER JAMES: What year do they go from
21 12-10, is that reflected in the chart? Do they reduce the
22 number to 10?

23 THE WITNESS: It would not be reflected to my
24 knowledge; I --

25 COMMISSIONER JAMES: Does that have a bearing on

1 it, that they reduced the number of records?

2 THE WITNESS: If you are looking at per tune?

3 COMMISSIONER JAMES: Per tunes, I am sorry.

4 THE WITNESS: If you are looking at per tune rate,
5 and interested in a per tune rate, it would have a bearing.
6 I don't know if there was ever a decided shift from 12 to
7 10; there certainly is a turn in that direction.

8 COMMISSIONER JAMES: Well, we have testimony
9 that there was. I just wondered.

10 THE WITNESS: Well, I mean a one time decision.

11 COMMISSIONER JAMES: Oh.

12 THE WITNESS: I don't think that ever occurred.
13 But there certainly has been a tendency, 12 tunes, I think,
14 were still prevalent in the early 70s, so it is not an
15 entirely dependent on that.

16 BY MR. FITZPATRICK:

17 Q Dr. Kiser, in connection with Commissioner James'
18 question about the reduction of the number of tunes, is it
19 your understanding that if you would have fewer tunes but
20 tunes of a longer duration, it is possible that the royalty
21 might not drop or might not drop in a ratio of 12 down to 10?

22 A No, that is certainly correct. The tune length
23 studies that the RIAA has done over the years has tended
24 to show a slight increase in the total time on albums,
25 regardless of the number of tunes.

1 Q Would you say that this chart -- Exhibit AA --
2 has any bearing on earlier testimony here that the recording
3 industry is a low price, high volume industry?

4 A I think this is evidenced by that. It is quite,
5 clear that the producers have not been trying to match their
6 price increases with inflation, and I presume both has the
7 competition and desire to increase volume.

8 CHAIRMAN BURG: Mr. Fitzpatrick, I have a
9 question.

10 MR. GREENMAN: I may have missed it, but did you
11 give the source of the green line on Exhibit AA?

12 THE WITNESS: Yes, I did. That is produced by
13 the Bureau of Labor Statistics.

14 BY MR. FITZPATRICK:

15 Q All right, let's turn now, having looked at
16 inflation both in terms of mechanicals and price, to a new
17 subject, the historical effective rate. There has been a
18 great deal of discussion, Dr. Kiser, here, about the so-called
19 historically effective rate for mechanical royalties.

20 Do you think that there is such a thing as a
21 historically effective rate?

22 A No, I don't really believe so. It seems to me
23 the rate is varied. There is really -- if there is anything,
24 it is just a share and the share has varied all over the
25 map because of changes in tune content and changes in album

1 prices.

2 Q Now, the publishers have designated a base period
3 of 1955-1965 as their reference point. And as a period in
4 which they identify a historically effective rate which they
5 claimed was 6 per cent. Do you agree with that analysis?

6 A No, not really. It seems to me that if one looks
7 at the relationship between 6 per cent and the pattern of
8 mechanicals as a percentage of wholesale over that time,
9 that not only is it well below 6 per cent converted to list,
10 it would be well below 6 per cent. That is more of the peak
11 than the rule.

12 But also, the spread between 6 per cent and the
13 actual level of mechanical royalties as a function of list
14 varies throughout the period, so one would have to ask if
15 there was an effective rate, why is the spread varying so much.

16 What I tried to do was take a look at mechanical
17 royalties as a percentage of wholesale price, and then I
18 converted to list just by dividing by two, on the old rule of
19 thumb that lists wholesaler about 50 -- that wholesale is
20 about 50 per cent of list.

21 And I did a series of rolling averages from
22 1955-1966, look at what the relationship was, for the
23 figures that we had available. From 1955-1959, if I can
24 share these figures with you, mechanicals as an average --

25 MR. ZUCKERMAN: Madam Chairman, could we ask

1 that Dr. Kiser indicate where he is drawing the figures
2 from?

3 THE WITNESS: They are the same figures used by Dr.
4 Nathan used on page 37 of his report, Mechanical Royalties,
5 which I believe are drawn from the CRI '75 report.

6 MR. ZUCKERMAN: Thank you.

7 THE WITNESS: I just looked at what these relation-
8 ships would be if we took a rolling average of 4-year
9 periods. And if you take the figures we have for 1955-1959
10 mechanicals were about 4.6 per cent of list, total list.

11 As the RIAA report shows. From 1957-1961,
12 which is the next data point where we could begin a four-
13 year group, it rose to 4.9 per cent.

14 From 1959-1963 again skipping the missing year
15 there of 1958, it was 4.9 per cent. From 1960-1964
16 mechanical royalties as a per cent of list were 5.1 per
17 cent, from 1961-1965 they were 5.2 per cent. And that is
18 the peak, from 1962-66. It goes back down to 5.1 per cent.
19 And then tends to trend lower after that.

20 So it seems to me that 5.2 is the peak if one
21 smooths out some of those variations and 6 per cent is
22 certainly a judicious amount of rounding, they are not
23 really defensible as the rate.

24 Q All right, put aside, Dr. Kiser, the question
25 of the statistics in the rate, and the validity of a
claim that the rate was 6 per cent.

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Tape 2

1 In any event is it your view that it is
2 appropriate to establish a royalty today based upon some
3 historically effective rate or some prior period in our
4 economic history?

5 A Well, I certainly think it is preferable to base
6 a rate on existing economic conditions, and I don't state
7 that in a statutory sense, but simply to reflect existing
8 relationships and existing pressures on the marketplace;
9 there have been a number of changes since the 1955 and '65
10 period, which I would gather others have testified to.

11 But it seems to me that 3 stand out, that I
12 could identify; the first was that this relationship between
13 the song and technology has certainly changed in the inter-
14 vening years, and costs of that technology are now more in
15 a record.

16 It seems to me that the rise of the singer-
17 songwriter makes a considerable difference between the
18 present era and that of 1955-65.

19 And finally the distribution network has changed
20 dramatically. I remember in the early 60s one could go into
21 Harvard Square and buy records by listening to them in a
22 booth; we made a lot of progress since then, and the artwork
23 and the selection of records thru high-volume distribution
24 network certainly makes the period from '55-'65 considerably
25 different than that which we have now.

1 Q All right, well, let's turn then from the
2 historically effective rate issue to a consideration of the
3 consequences for the proposed rate increase.

4 First, let's look at the impact, the size of the
5 proposed increases here on recording companies. What would
6 in your judgment be the dimension of the -- the economic
7 dimension of the proposals for increased rates on record
8 companies?

9 A Well, the 6 per cent rate on a front line
10 \$7.98 record would imply a rate of 48 cents. And that is
11 an increase over 27-1/2 of 74 per cent.

12 On an \$8.98 record it would be 54 cents. And
13 that is an increase of 95 per cent, almost a double; as
14 we will discuss momentarily, there is a compounding effect
15 here where the mechanical royalty set at a percentage would
16 yield a higher amount perhaps caused by the institution
17 of that rate alone.

18 In other words, a 6 per cent rate may cause
19 increases in the list price, which in turn will cause an
20 increase in the rate. And we will look for that in just a
21 moment. So the \$8.98 increase of 95 per cent should occur
22 not only on those albums that are currently \$8.98, but
23 also those that are currently \$7.98 and may have to move up
24 in response.

25 The 8 per cent rate on a \$7.98 album, rounding

1 off, would be 64 cents for the album for one product,
2 full statutory rate. And when one looks at the increase
3 over 27-1/2 cents that has been currently paid, one sees
4 an increase of about 132 per cent.

5 On an \$8.98 product, it would be 72 cents. And
6 that is an increase of 161 per cent over the current
7 27-1/2 cents. And here again, we have the compounding
8 effect that an increase of that magnitude almost surely
9 would cause in and of itself an increase in list price,
10 and if, for example, the \$8.98 or the \$9.98, that would
11 imply a mechanical royalty rate of 80 cents, and that is
12 an increase of 190 per cent over the current 27-1/2.

13 If one looks at the 5-cent increase, it is a
14 direct 82, proposal, it is a direct 82 per cent increase
15 ver 27-1/2. Plus one would almost surely have to revise
16 the overtime characteristics of the present loss so that
17 it makes sense, presumably to a penny a minute so that
18 over 5 minutes you would be paying increments.

19 And we calculate that that kind of an increase
20 would add another four per cent to the increase for a total
21 of about 86 per cent. So in all of these cases, we are
22 looking at -- on a front line album -- an increase from
23 anywhere from 74 per cent in mechanical royalty rate to as
24 much as 190 per cent. And this implies a sizeable amount
25 of dollars as well as the percentage of figures.

1 MR. GARCIA: Excuse me, did I see your last
2 comment was we are going from a 4 per cent as much as
3 190 per cent increase?

4 THE WITNESS: No, 74 per cent. To 190 per cent.

5 MR. GARCIA: And that is just in the base period
6 from 1955 --

7 THE WITNESS: No, that is based not at all on any
8 base period. That is just taking a look at what the current
9 mechanical payment is on a front line album, which is 27-1/2
10 cents and saying, "Okay, if the rate were 6 per cent of the
11 present list price, what would the payment be?" And what
12 is that percentage difference?

13 Okay, so if we had a \$7.98 album now, and
14 we paid it off at 6 per cent, it would become 48 cents,
15 and that increment from 27-1/2 to 48 is an increase of
16 74 per cent.

17 MS. DEAL: Thank you. Before we get too far
18 afield, I still will be given 8-1/2 by 11 in your chart?

19 THE WITNESS: Yes.

20 MR. SHERMAN: No, I didn't say the rate.
21 I said we would be doing that with everything.

22 MS. DEAL: Oh. All right.

23 BY MR. FITZPATRICK:

24 Q Now, you have talked about each of these changes
25 would involve considerable dollar amounts over the present

1 mechanical royalty payments, ranging from 74 to 190 per
2 cent over present payments.

3 Let's look together if we could, at some sources
4 for financing this increase in payments. From your analysis,
5 could this increase be financed out of record company profits?

6 A No, there aren't any right now.

7 Q What about out of promotions and selling expenses.
8 Could that be an item that would provide a source of funds
9 for these added payments?

10 A Well, only at the risk of reducing volume.
11 Each of the managements of the companies has to learn for
12 itself what the response of the marketplace is for selling
13 and promotional expenses that it engages in.

14 And there has been some criticism of the level
15 of that expense. Others in the industry have testified
16 to the composition of that expense. And why they spent it.
17 I won't attempt to second-guess any of that. I would just
18 point out that it is commonplace in business that expendi-
19 tures for advertising and promotion are somewhat made on a
20 trial and error basis with a certain amount of learning that
21 goes on to define and refine the response of the marketplace
22 to such expenditures.

23 I presume some of that was going on in 1979.
24 Certainly national television advertising is a fairly new
25 element of record company promotion, and advertising.

1 So I would just say that sure, you could cut
2 back in an area like that. But you risk a reduction in
3 volume, and I suspect every company management would have
4 to make some judgment about whether or not they were willing
5 to risk that.

6 Q And that risk in reduction and volume would
7 affect composers as well, I presume.

8 A Well, absolutely. The volume falls, as a result,
9 everybody gets their --

10 Q Now, what about G & A as a source of financing
11 this expansion.

12 MR. ZUCKERMAN: Madam Chairman, I want to spe-
13 cifically object to this particularized line of examination
14 on sales and promotion in general administrative, because
15 this is one of the areas where Dr. Kiser's answers are
16 relying on not only individual questionnaire responses but
17 also aggregated line items that were not produced in
18 response to our requests and Mr. Greenman's request.

19 MR. FITZPATRICK: I think the aggregated line
20 items were, and I think that you have a question here, it
21 would be perfectly appropriate for the Tribunal to pose
22 these questions or for you to pose them on cross examination.

23 MR. ZUCKERMAN: Well, Mr. Greenman pointed out
24 very eloquently on Friday that the promotion expenses in
25 the RIAA or CRI questionnaire were broken down into five

1 different items for the type of sales and promotion expenses.
2 The aggregation that was produced, if that is what it was,
3 had none of those items broken down in that manner, and we
4 have yet to see any aggregation according to those line
5 items.

6 Dr. Kiser is now testifying as to the necessity
7 of those components without knowing what those components
8 are.

9 THE WITNESS: With all due respect, I think my
10 answer is based upon general knowledge of business.

11 MS. DEAL: If it is based on general knowledge
12 of business --

13 MR. FITZPATRICK: Could I please proceed. You
14 will have your chance.

15 CHAIRMAN BURG: The objection is noted.

16 MR. ABRAM: Madam Chairman, thank you. But I
17 want to make this observation so that our position is clear.
18 I have made standing objection, but I think it is important
19 that as we go along, we understand that there are things
20 that really are not even really embraced by the standing
21 objection.

22 For example, as I understand that the posture
23 of this witness' testimony at the moment, he was asked whether
24 or not G & A or promotion costs could be reduced, and he
25 said only if they were for loss of business, or words to
that effect.

1 Therefore, he is having to assume that all these
2 businesses are efficient. And either that is based on his
3 knowledge based on these questionnaires, which we are not
4 able to test, because of the non-production, or they are
5 based on his textbook knowledge, which might be as relevant
6 as to the fact that price, or it is based on Billboard
7 or gossip in the trade.

8 Now, if his testimony, and I am just -- I am
9 not quarreling with the root, I am just -- I think, but I
10 am not quarreling with it. All I am saying is that unless
11 this witness precisely tells us what item and what
12 questionnaire or what data he got which has so far not been
13 turned over to us, he relies upon, to say that you can not
14 produce G & A, you can not produce promotion costs, you
15 can not produce artist royalty or you can not produce any
16 of the other components with respect to any one of the
17 companies, unless he gives us that figure, we are absolutely
18 faced with a situation in which our hands are tied behind
19 our back by the violation of the rules of the Tribunal.

20 MR. FITZPATRICK: Madam Chairman, may I just
21 say something very briefly. A couple of points, first of
22 all, Dr. Kiser had indicated that he is basing his testimony
23 on his understanding of the industry, and that would include,
24 presumably, though I don't know, the aggregate financial
25 data that is collected, but it was based essentially on

1 his general understanding of the industry; second, I think
2 his testimony on promotion and selling expenses, it is a
3 risky matter in cutting expenses, in this area, where there
4 is the chance of a loss of volume.

5 I must say that Dr. Nathan -- Mr. Nathan, with
6 no understanding, with no analysis of the recording industry
7 at all, testified at great length of his view, just on the
8 basis of aggregate numbers, that the industry was profligate
9 and wasteful. With that specific knowledge, total specu-
10 lation, we have here an expert that has known the industry
11 and has studied the industry over many years.

12 I believe that these observations, based upon
13 his understanding, of the various components of recording
14 industry expense are quite appropriate. And I would like
15 to proceed.

16 MR. ABRAM: I don't object to his proceeding --
17 I would just like the documentation that he has. That is
18 all.

19 CHAIRMAN BURG: I understood Mr. Abram and you
20 may proceed.

21 BY MR. FITZPATRICK:

22 Q Now, the point that I think we were -- I
23 believe we had arrived to, was the question, in your judgment
24 can increases of this dimension be financed out of G & A?

25 A I will try to indicate the basis on which I am
making my comments whenever I can.

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1 I think that from my perspective is a very
2 difficult question to answer. It is quite clear that over
3 the '77-'79 period, per cent of sales going to G & A was
4 right in line with a lot of other businesses.

5 And I base that only on a cursory looking thru
6 Dun statistics. It is also clear that the level of G & A
7 rose in 1979. Now, you have two effects operating there.
8 One, sales by itself is declining, sales level was declining.

9 And that is going to create a tendency for
10 certain line items in the expense categories to achieve a
11 higher percentage number, all by itself. Secondly, I think
12 we are all aware that the industry had a significant returns
13 problem in 1979 and that companies were forced to establish
14 return handling centers purely for the purpose of ahndling
15 returns.

16 The expense of those centers would be in G & A
17 as well. As well as interest, costs, which we don't have
18 any separate figures on, and we all know that interest rates
19 were rising throughout the period. So I simply point
20 out there are some reasonable explanations for an increase
21 in G & A in 1979.

22 But clearly, I think the answer to all of these
23 questions is competition isn't going to let you do much.
24 It is not going to let you make unilateral slashes in
25 selling and promotion, to G & A, to the extent that you are

1 in a competitive market place.

2 Promotional rivalry competing for labor inputs,
3 is going to place a bound on just exactly what any one
4 manager can do.

5 Q Well, turning from G & A then to at last major
6 source, can -- could these increases of this dimension be
7 financed out of cost of goods sold?

8 A Here again, and I will base my testimony on
9 the data in the report. Aggregate data in the report. One
10 can see by looking at Exhibit 1, as we have submitted to you,
11 actually, excuse me, we didn't -- it is Exhibit 3.

12 Every time I refer to Exhibit 3 I was referring
13 to the revised for the new --

14 Q The one we got last week.

15 A That is correct.

16 And if one simply looks at the gross margin
17 figure, which is net sales minus the cost of goods sold,
18 and read across the various lines there, you can see that
19 the margin in this industry is at a very low level
20 compared to what it has been over the last 6 years.

21 It has fallen from approximately 35 per cent in
22 1974 to just under 30 per cent now. As you can see, the
23 historical range is between 34 and -- well, the high there
24 in '77 gets up to 38 per cent, 37.9 per cent. So here again,
25 you -- the gross margin of the industry as reflected by these

1 data is at a historically low level over the recent period,
2 and I have to ask whether this is due to any kind of
3 profits, I don't know that it would be, but so many of
4 the costs of goods are driven by costs out of the record
5 companies control, and I am not bullish on that aspect.

6 Now, you can get some short term responses,
7 there is no question about that. I think Mr. Yetnikov
8 testified that he has been able to get some reduction in
9 artist royalties on mid-priced product; I don't know
10 whether this is an accurate statement or a long term
11 trend. My own guess would be that inevitably the competitive
12 forces that all of us deal with every day including whether
13 we can take our services elsewhere, will affect how much the
14 artist is willing to accept lower royalties.

15 The production costs of those who have testified
16 are being driven very hard by inflation, mechanical royalties,
17 of course, we are discussing here, in general I would say
18 that I don't believe that there is much hope for reduction
19 in cost of goods sold.

20 Q Well, in light of those conclusions, how would
21 any increase, any increase, have to be financed in your
22 judgment?

23 A I would point to the testimony of others, who
24 have indicated that there will be some reduction in releases,
25 there will be some reliance or increased reliance, based

1 on proven artists, as opposed to unproven artists, those
2 are, by the way, items in costs of goods, it is hard to
3 react to the total cost of goods concept, but to that
4 extent, there would be some reduction in cost of goods.

5 But it seems to me inevitable that some pass
6 to the consumer, in fact, substantial pass thru the consumer
7 would occur, simply because the industry is in the shape
8 that it is in.

9 Q Could you -- have you done any analysis in
10 terms of the past impact on consumers?

11 A Yes, I have.

12 Q Could you describe that for us, please?

13 A Yes, sir.

14 COMMISSIONER JAMES: Before he goes to that, may
15 I ask one question? How did you say the artist item would
16 affect the cost?

17 THE WITNESS: Well, if you look at the statement
18 there, total cost of goods is all the items on our exhibit
19 from number 5 through number 11.

20 COMMISSIONER JAMES: And number 8 is artist
21 royalties?

22 THE WITNESS: Number 8 is artist royalties.

23 COMMISSIONER JAMES: Right.

24 THE WITNESS: And Mr. Fitzpatrick asked me
25 whether a reduction in cost of goods sold might be one

1 area where the -- a higher mechanical rate might be offset.
2 The only evidence I have of any reduction in artist
3 royalties is the testimony of Mr. Yetnikov, who said
4 that he was able to get some reductions in the rate on
5 the lower priced product.

6 COMMISSIONER JAMES: But isn't that an item
7 where if it was reduced it would create another source of
8 revenue?

9 THE WITNESS: It wouldn't create another
10 source of revenue, sales, I don't know why sales would
11 increase, simply from --

12 COMMISSIONER JAMES: Forget about sales -- we
13 are talking simply about cost of goods. One of the items
14 over the years that has gone up, I thought the testimony
15 indicated, was the percentage of artist royalty.

16 THE WITNESS: No question.

17 COMMISSIONER JAMES: Is that a fact?

18 THE WITNESS: That is.

19 COMMISSIONER JAMES: Where did they get the
20 wiggle room to increase that over the years?

21 THE WITNESS: I don't buy the notion of
22 wiggle room.

23 COMMISSIONER JAMES: Well, where do they get the
24 -- it went up.

25 THE WITNESS: It went up because the --

1 COMMISSIONER JAMES: Did it cut into the
2 record company's profits?

3 THE WITNESS: I don't think you can isolate
4 any one thing as cutting into record company profits. I
5 testified yesterday that the trend, certainly for domestic
6 profits, has been declining.

7 And currently, right now, of course, it is very
8 low.

9 COMMISSIONER JAMES: 10 years ago, what was the
10 artist royalties?

11 THE WITNESS: May I consult the old Glover
12 studies?

13 COMMISSIONER JAMES: Yes.

14 THE WITNESS: I am reading from page 48 of the
15 1975 statement to the House Committee.

16 MR. ZUCKERMAN: Dr. Kiser, just because every-
17 body might not have copies of that, I might also point
18 out that the same information on artist royalties taken
19 from the Glover study appears on page 20 of the submission
20 of Mr. Nathan dated April 21 of this year.

21 THE WITNESS: Reading from Line 4 on that
22 page, the answer, Commissioner, is 14 per cent.

23 COMMISSIONER JAMES: And what is it today.

24 THE WITNESS: Our figures for 1979 indicate
25 25.4 per cent.

1 COMMISSIONER JAMES: For artist royalties.

2 THE WITNESS: Right.

3 COMMISSIONER JAMES: All right, if artist
4 royalties has stayed at 14.6 today, that is based on a
5 percentage, isn't it?

6 THE WITNESS: Yes, it is.

7 COMMISSIONER JAMES: All right, the record
8 companies would have had a profit last year, wouldn't they?

9 THE WITNESS: Well, I imagine prices would be
10 lower and volume would be higher.

11 COMMISSIONER JAMES: Assuming everything but --

12 THE WITNESS: Everything else would have been the
13 same?

14 COMMISSIONER JAMES: Everything else is the same,
15 suure, because oil has gone up, everything else has gone up --

16 THE WITNESS: All of the things being equal,
17 suddenly we could go back to 1979 and pay the artists 2/3
18 of what they got, or 3/5 of what they got instead of what
19 they got, yes, the companies probably would have been
20 profitable. I would have to run the number through a
21 computer.

22 COMMISSIONER JAMES: All right, there has been
23 substantial testimony that all the artist contracts are
24 negotiated. It is a give and take situation. I mean, from
25 your previous testimony, I have to assume that you have read

1 and reviewed that transcript carefully, is that a correct
2 characterization?

3 THE WITNESS: I read some.

4 COMMISSIONER JAMES: All right, well, did you
5 see that in there, that they are negotiated?

6 THE WITNESS: That is consistent with my general
7 understanding.

8 COMMISSIONER JAMES: In a bargaining situation,
9 if one item goes up to a point where that is set, you know,
10 they can't -- the cost of records, evidently, because of the
11 oil increase, is now a set figure. There is a master
12 Union contract that every trumpete player and every drummer
13 guitar player in -- that goes in a recording studio gets
14 a union rate. That is set.

15 If this Tribunal were to increase that mechanical
16 rate, up, that becomes a set rate. If the record company
17 wanted to hold the line, if only room, it seems to me that
18 they could hold the line on it, is to -- and the negotiations
19 with the artist. If the price is at a certain figure, give
20 figure, and they don't want to increase it, it seems that
21 they could go and say, "Look, there is no more money here."

22 "Here is what you got." I mean, it is strictly
23 a union type of basic negotiation. Isn't that possible?

24 THE WITNESS: The only trouble I have with that
25 is that I tend to go back to the nature of demand and look

1 and see what is driving the marketplace and what is driving
2 volume; and it seems to me it is the hardest and dominant
3 -- and predominantly the singer-songwriter.

4 I am not convinced that those people can't
5 compete for record company attention and contracts with a
6 great degree of hard capital. I don't think the companies
7 chose to increase artist royalties. I don't know any
8 businessman who chooses to pay a greater and greater
9 amount of a certain cost.

10 COMMISSIONER JAMES: I would agree.

11 THE WITNESS: And therefore the question is well,
12 why did it occur. Baseball salaries have accelerated out
13 way beyond what anybody ever imagined. Did the owners of
14 those teams choose to pay those prices?

15 Well, they certainly agreed in the sense of
16 negotiation; but if you asked them did they prefer to pay
17 half of it, they would say sure. So one competes for labor
18 just like every other input. And I question -- I think
19 to some extent you are correct. I think some substitution
20 between the two may occur. But for the superstars I don't
21 think it will occur. I don't think Barbra Streisand is
22 going to take a cut in artist royalties, under any
23 circumstances. And if CBS won't have her, there are a
24 lot of others clamoring for her services.

25 COMMISSIONER JAMES: Well, they will also be

1 faced with the same problem.

2 THE WITNESS: Well, if you follow that logic,
3 to its conclusion, I wouldn't be a bit surprised to see
4 some of the supergroups starting their own record companies.

5 COMMISSIONER JAMES: But they will still be faced
6 with the same problem.

7 THE WITNESS: No they won't, not entirely,
8 because they have pricing power in the marketplace as well.

9 COMMISSIONER JAMES: Explain that, I don't
10 understand.

11 THE WITNESS: If one follows it to a logical
12 conclusion, the singer songwriter is the source of the
13 dominant source in the industry of music, both the tune and
14 the performance. And the customer appears to be willing to
15 pay for that --

16 COMMISSIONER JAMES: The higher price?

17 THE WITNESS: Well, that is exactly right, and
18 that hasn't been, as I mentioned yesterday, the policy
19 of this industry, historically, the price there, the top
20 product, their front line product, kind of is a lost leader
21 if you will, although I am not claiming they make a loss
22 on it.

23 To get people into the stores to buy catalog
24 records, to see the material in the stores, to make impulse
25 purchases, there has been a constant effort to develop
 volume.

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1 And one of the ways to do that was to price the
2 top 20 records at a bargain, and I know that is certainly
3 the way that the competition in my area of the country
4 works. It is just like some of the bookstores offering
5 New York Times best sellers at a discount and everything
6 else is at list.

7 COMMISSIONER JAMES: Do you really believe --

8 THE WITNESS: So I have some doubt about whether
9 or not -- if this were forced into this area, whether or
10 not the front line product would remain at the lower price.

11 COMMISSIONER JAMES: But do you really believe
12 that, take the top 10 artists right now, that they couldn't
13 get -- they got cut, they would go and start their own
14 record company?

15 THE WITNESS: Well, we know that has occurred
16 on certain cases. It certainly hasn't been frequent,
17 but Beals did it. And the Allman Brothers did it. And
18 it is not out of the realm of possibility.

19 COMMISSIONER JAMES: All right, let's take the
20 other side of the coin. Where does it stop regardless?
21 You are getting 25 per cent now.

22 THE WITNESS: Yes.

23 COMMISSIONER JAMES: What happens if they say
24 "We want 50 per cent."

25 THE WITNESS: Well, they don't bargain that way

1 of course, they bargain in the sense of what their
2 peers are getting and what they think they are worth,
3 and --

4 COMMISSIONER JAMES: Somebody has to take the
5 first step.

6 THE WITNESS: Yes, that is correct.

7 COMMISSIONER JAMES: All right.

8 THE WITNESS: Who is on top at the moment.

9 COMMISSIONER JAMES: Now, they have -- and they
10 are on top and they are just on the way up.

11 THE WITNESS: Yes.

12 COMMISSIONER JAMES: And they are getting 25
13 per cent on this record that is selling this whole \$5
14 million, really be hypothetical about it?

15 What is to stop them from going back and say,
16 "On our next album we want 35 per cent." At what point
17 does the record company dig a trench, and say, "No more."

18 THE WITNESS: At the point where they don't
19 think they could make money at the volume that artists
20 are producing. So take an artist like Billy Joel. Billy
21 Joel is doing very well right now. One of the top
22 records in the first 6 months of this year was hit record,
23 Glass Houses. I have no information or knowledge of what
24 he is paid. But CBS undoubtedly has some idea of how
25 well the next Billy Joel album will do, albeit there is a

1 huge risk around that. There is a lot of variation
2 around, but I guess as a reasonable business man, CBS,
3 whether it is Mr. Yetnikov or whoever, would make a judgment
4 about whether Billy Joel's demand can still allow him to
5 make a profit.

6 COMMISSIONER JAMES: Okay, and in that
7 consideration, is what he paid for mechanicals, isn't it?

8 THE WITNESS: Yes, I agree with that.

9 COMMISSIONER JAMES: Okay, thank you.

10 COMMISSIONER COULTER: Dr. Kiser, you are
11 suggesting that -- I think you said that the major singers
12 have -- I forget the phrase you used, but a control of the
13 price, a relative control of the price.

14 THE WITNESS: No. I was suggesting in the
15 hypothetical that if forced to the wall --

16 COMMISSIONER COULTER: No, no, before that
17 last question of Mr. James, you -- at the beginning of
18 that, I think you said that the major singers have a certain --
19 demand a certain price on the market.

20 THE WITNESS: For their services?

21 COMMISSIONER COULTER: For their product.

22 THE WITNESS: Well, no, I meant for their services.

23 COMMISSIONER COULTER: You meant for their ser-
24 vices, excuse me. Thank you.
25

1 BY MR. FITZPATRICK:

2 Q Let's turn to your analysis of the past impact
3 on consumers of these various rate proposals.

4 A Okay.

5 Q Could you describe that for us, Dr. Kiser?

6 MR. SHERMAN: We will mark the chart, the
7 Effect of the Present Mechanical Royalty Rate on the Actual
8 Retail Price of Recordings, as RIAA Exhibit BB.

9 (Exhibit BB was marked for identification.)

10 THE WITNESS: Well, as I have discussed, it is
11 not easy to estimate what the past effects of any enormous
12 increase in costs will be on any product, and you have to
13 make some assumptions, and I wanted to indicate to you in
14 light of the analysis the assumptions I made, and what it
15 is all based on.

16 MR. GREENMAN: Dr. Kiser, before you go on,
17 can I ask you to step a little to the left?

18 THE WITNESS: I am going to use both of these
19 easels at some point and I may have to move the chair.
20 But let me move this over here, for the time being.
21 Is that all right, can you see?

22 MR. FITZPATRICK: Well, we are most interested in the
23 Tribunal seeing it.

24 MR. GREENMAN: I think you might let other counsel
25 see it too.

1 THE WITNESS: This chart has introduced the
2 concept that I am using -- those of you who have seen
3 some of the previous studies that we have done will recognize
4 it. What I have done here is indicate for a \$7.98 album
5 what the typical pattern of distribution is and I will
6 explain what I base these things on.

7 This is an illustration for front line products
8 currently. Now, this has nothing to do yet with any increase
9 in the mechanical royalty. We know from our weighted average
10 wholesale price study that for the period covered by that
11 study the record prices -- record distributors, record
12 companies average price to distributors for a \$7.98 album
13 was \$3.99.

14 And that is recorded here. We also know from
15 the income statistics that we have developed that the gross
16 margin was, as I indicated earlier, about 30 per cent, so
17 I have simply applied that general 30 per cent figure.
18 In dividing that through, indicates that the record
19 companies' cost -- in order to have a margin of 30 per
20 cent, would be \$2.79.

21 CHAIRMAN BURG: You have data supporting that
22 \$2.79?

23 THE WITNESS: That is correct.

24 CHAIRMAN BURG: Okay.

25 THE WITNESS: Well, it is based on the survey

1 data, but yes, I -- the distributor's margin would vary
2 depending on the distributor. A certain subdistributor
3 might work on 5 per cent. Others distributors might work
4 on more. The 18 per cent is drawn from a New York Times
5 article on independent distributors. I did no survey of
6 distributors. I think it is a pretty good number.

7 The fully owned distribution networks
8 of record companies work on a slightly lower margin,
9 17 per cent -- the independents work on a slightly lower
10 margin, around 19 per cent; I chose 18.

11 There again, we take the \$3.99 and ask what
12 price then would be the price for the retailer to permit a
13 margin of 18 per cent, and that becomes \$4.87. The
14 retailers margin is very conservatively stated. I think
15 most retailers work on a higher margin. the way I got the
16 16 per cent figure was I took the weighted average price
17 from the CBS data that we submitted on April 7 for -- I
18 think it was all albums, \$5.79, so this is probably a
19 pretty good estimate.

20 I checked on the record store I usually go to,
21 and they are selling \$5.99's. This margin may be slightly
22 higher. And came up with the share, or the portion of the
23 consumer price that is the retailer's margin. So that is
24 an illustration of the current distribution setup for a
25 \$7.98 list album.

1 COMMISSIONER JAMES: So I understand it,
2 the artist roaylty is in that first item?

3 THE WITNESS: Yes, it is.

4 COMMISSIONER JAMES: But it is based on the
5 \$7.98 calculation?

6 THE WITNESS: Yes, it is. I don't know
7 offhand what it would be. It would be a portion of the
8 \$2.79. Now, also, mechanical royalty is a portion of
9 the \$2.79. And it is 27-1/2 cents, which is about 9.8
10 per cent. And all of the components of this cross are
11 marked up throughout the distribution chain and what this
12 column shows is simply the portion of the markup that
13 accrues to mechanical royalties.

14 So that by the time the record company sells
15 the record, to the distributor, the mechanical royalty
16 is 39 cent, still 9.8 per cent of the price, all the way thru.
17 By the time it is sold to the retailer, it is 48 cents.
18 And by the time it is sold to the consumer, it is 57 cents.

19 I just want to introduce this as an exhibit --

20 COMMISSIONER JAMES: You have lost me, please.
21 Start over.

22 THE WITNESS: If one looks at the record
23 companies cost there is lots of items in that number.

24 COMMISSIONER JAMES: All right.

25 THE WITNESS: One of them is mechanical.

1 Mechanicals, production costs, selling
2 and promotion expenses, that are fixed, everything, and
3 one of which is mechanical. This column merely isolates
4 that portion of the \$2.79 which is due to mechanicals.

5 Okay. You could add another column over here
6 for production expense and another column for G & A expense.
7 As the \$2.79 works its way through the distribution chain,
8 it becomes \$5.79. So every component of the \$2.79 has
9 been marked up as well as the aggregate of the \$2.79.

10 Okay. In other words, I could have split the
11 \$2.79 into \$1.40 and \$1.39, and run two columns and still
12 come up with a \$5.79 price; but I would have said half.
13 The first half, be this way and the second half would be
14 that way. Does that help?

15 COMMISSIONER JAMES: And this is a valid
16 economic theory, that you take the components and balance
17 them out?

18 THE WITNESS: Yes, to the distributor, there is
19 -- the distributor doesn't distinguish what the component
20 prices are. All the distributor cares about is that you
21 are charging him \$3.99 and he has earned a profit, and he
22 has to cover his expenses and his markup at approximately 88
23 cents.

24 COMMISSIONER JAMES: Well, the thing that disturbs
25 me is you are adding the second item, Record Companies
Average Margin of 30 per cent. You are attributing that

1 to the mechanical, and I --

2 THE WITNESS: Oh, some portion is attributed
3 to mechanical and some to every other cost that the
4 record company endures. That is just the algebra of it..

5 COMMISSIONER JAMES: Go on. I just don't
6 understand it. Probably not important for me to under-
7 stand it.

8 THE WITNESS: Well, you will feel like it is
9 on the next chart. Maybe I can clarify it.

10 COMMISSIONER GARCIA: Dr. Kiser, should we,
11 on the amount due on mechanical, should we not have stopped
12 at the 48, since 6 per cent of \$7.98 is 48 cents, instead
13 of projecting other figures?

14 I guess that is -- I don't understand that last
15 projection you made there.

16 THE WITNESS: This doesn't have anything to
17 do with the 6 per cent yet.

18 COMMISSIONER GARCIA: Okay. You are going
19 to cut --

20 THE WITNESS: This is just a picture of what
21 the current marketplace looks like. Illustratively.
22 I am introducing this chart only because we are going to
23 go to some other charts that have the increase in it.

24 COMMISSIONER GARCIA: Okay.

25 THE WITNESS: And I wanted to introduce the
concept.

1 COMMISSIONER COULTER: Are you -- according
2 to that chart, the 92 cents difference between the price of
3 the retailer and the price of the consumer --

4 THE WITNESS: Right.

5 COMMISSIONER COULTER: Now, never mind.

6 THE WITNESS: Let me make one further point.
7 And that is that I have also reported here the so-called
8 consumers discount. It is a \$7.98 list item and he is
9 interested in buying it at a discount. That is the pattern,
10 and he expects to pay a discount of price.

11 So the difference between \$5.79 and \$7.98 list
12 is the amount of his discount, if you will, and that comes
13 to about 27.4 per cent currently.

14 COMMISSIONER JAMES: I think the problem I
15 have been having, I have been looking at the title.
16 The Effect of Present Mechanical Royalty Rates. I just
17 don't understand.

18 THE WITNESS: Suppose you and I were in the
19 car business.

20 COMMISSIONER JAMES: All right.

21 THE WITNESS: And we sell cars and we add 10
22 per cent to our selling price. So we bought a car for
23 \$3,000 and we sold it for \$3300. And the question is of
24 the 3300, what portion of that to the next guy down the
25 line was due to the labor, the engine, the parts, okay,

1 and the answer is the same per cent that was due at the
2 \$3,000 level, because all we did was just add 10 per cent.
3 Okay?

4 COMMISSIONER JAMES: Yes, but the cost of that
5 good was still \$3,000.

6 THE WITNESS: To us, but to the next guy it
7 was \$3300. And -- well, and the distributor. And so the
8 question is how much, suppose you didn't ask the distributor,
9 well, of what you paid, how much of your price went back to
10 artist royalties, mechanical royalties, okay, and he would
11 say, "Gee, the same per cent."

12 COMMISSIONER JAMES: What is the importance
13 of this exercise?

14 THE WITNESS: I think it will become clear in
15 the next chart.

16 COMMISSIONER JAMES: All right, I am going to
17 hold off then.

18 THE WITNESS: I am now going to put this over
19 here, simply as a reference point, the chair might get in the
20 way.

21 MR. SHERMAN: It is an exhibit entitled the
22 Effect of 6 Per Cent of List. Mechanical Royalty Rate on
23 the Actual Retail Price of Recordings as RIAA Exhibit CC.

24 THE WITNESS: Okay, now this may get a little
25 complicated. Pointing between charts. Now, we take

1 what we -- this was out initial condition, our initial
2 setting. And the 6 per cent of list, mechanical royalties
3 is installed. So for a 7.98 record, the mechanical
4 royalty now goes to 48 cents. It was 27-1/2 cents. So
5 there is an increase rounding off of 21 cents, in our
6 costs. So this number, \$2.79, goes up 21 cents, and
7 become \$3.00.

8 Okay; so suddenly our cost is now \$3.00. All
9 other things being equal. Now, we have a pricing decision.
10 And the pricing decision is do we maintain this margin, do
11 we shrink, do we cut back, that was the question we were
12 discussing earlier, all of these exhibits are based on the
13 assumption that margins will stay the same.

14 The reason for that is first of all, history
15 shows that the margins of the distribution network and
16 the record companies are -- they fluctuate, but they tend
17 to be fairly constant, and over the long run they are
18 going to be the same.

19 Secondly, this is a very conservative approach,
20 because as I pointed out, the record companies margin of
21 30 per cent is low by historical standards. It is much
22 more likely that because they are losing money right
23 now, that they would like to get that margin up around
24 35 per cent, which is more in the historical norm.

25 So I have said yes, that 30 per cent is a

1 perfectly reasonable estimate to imagine that the record
2 companies would at least maintain a margin of 30 per cent;
3 so now, do the same analysis --

4 COMMISSIONER JAMES: First of all, again, so
5 I can follow what you are saying. How do you arrive at that
6 point, 40 cents, now?

7 THE WITNESS: The current mechanical royalty
8 is 27-1/2. On a front line album of 10 tunes, 2-3/4 cents
9 times 10 tunes; I am assuming that 10-tune album throughout
10 this.

11 COMMISSIONER JAMES: Oh, okay. All right.

12 THE WITNESS: Okay. So it is currently 27-1/2.
13 Now, if it goes to 6 per cent of \$7.98, that is going to
14 be 48 cents, so the mechanical cost goes to 48 from 27-1/2.

15 COMMISSIONER JAMES: All right.

16 THE WITNESS: We are assuming no other changes
17 in costs, so the record companies' cost then bumps up by the
18 same amount. Okay. All right, now the price to distributor,
19 in order to create that 30 per cent margin, becomes \$4.29.
20 Once again, we go down the line. The distributor is going
21 to maintain his margins a lot of his costs vary on the
22 side -- on the dollar volume of what he is buying.

23 He has got insurance, he has got bad debt
24 expense, collectibles, financing expense, there is no
25 reason to think that the distributors margin would shrink,

1 especially if higher prices cause a reduction in volume.
2 So we have maintained these two margins all the way down the
3 line, and as I indicated before, when I used the 16 per cent
4 for the retail, I think is very conservative, from many
5 retailers except those that are in highly competitive areas,
6 it is probably quite a bit higher.

7 So again we take the price to the distributor
8 is \$4.29. He takes out 18 per cent of the selling price.
9 Which gives him a price of \$5.23. The retailer takes out
10 16 per cent, and the consumer price is now \$6.23. So we
11 raise the mechanical rate 21 cents, rounding off, but the
12 consumer price has now risen from \$5.79 to \$6.23.

13 No change in list, this is just the past
14 effects, of everybody down the line keeping their margins
15 whole. That \$6.23 is now an increase in the consumer
16 price of 44 cents an album, or 7.6 per cent. The percentage
17 of the price due to the copyright fee under the 6 per cent
18 rate, has risen from just under 10 over here to 16.

19 And finally, let me point out to you that
20 from the consumer's perspective, his royalties change.
21 He walks into the record store, buys a \$7.98 album, ex-
22 pecting it at a discount and the discount that he is
23 accustomed to is no longer there, It is now only a little
24 under 22 per cent where is used to be over 27, and on the
25 \$7.98 album, he is paying \$6.23. Okay.

1 And there's a real question there, whether
2 retailers would feel that that is an adequate discount,
3 based on present conditions, to pull people into the
4 stores, to get people to think that they are getting the
5 kind of deals that they are used to. The retailer could
6 put pressure on the record companies to raise list because
7 of that.

8 In addition, look at the record company's
9 price. This is a \$7.98 album. That's close to \$8.00.
10 Half of that price, which is the historical relationship
11 between wholesale and list, would be \$4.00. But look --
12 the record company is all the way up to \$4.29 already.
13 As far as I know, there are no \$7.98 albums at list that
14 are going for wholesale prices this high, so here again,
15 if the conventional relationships are going to be main-
16 tained in the industry, the record company will be under
17 pressure to raise list price.

18 COMMISSIONER JAMES: That is under the
19 assumption, of course, that when you add that 6 per cent,
20 that it goes up to \$3.00 but if you add that 6 per cent,
21 and it satys within a \$2.79, in other words if costs to the
22 store within -- then there would be the 48 cents over here
23 and the same number.

24 THE WITNESS: If the companies are able to
25 reduce other costs, in response to the increase, sure.

1 I think the idea that they would be able to
2 reduce all of it is wishful thinking. Some -- but the
3 assumption is based on a full --

4 COMMISSIONER JAMES: Why would they want
5 companies to increase the suggested list price?

6 THE WITNESS: The retailer works on the basis
7 that he is offering the consumer some kind of discount.
8 And the question is, I don't know, some of the retail
9 witnesses perhaps would tell you better than I can, but
10 the question is is this bigger reduction in the discount
11 that the consumer is getting, going to make him think it is
12 a good deal or is there going to be a long period of time
13 where he is thinking "My God, I used to pay less than \$6.00
14 for a \$7.98 album. Why am I paying over \$6. Why -- maybe
15 I should go to the store down the street."

16 MR. SHERMAN: How does the consumer know
17 what the suggested list price is?

18 THE WITNESS: If he shops from Billboard, it
19 is written on the charts. In addition, most record
20 stores use a coding system like LMNOP, or something like
21 that, the one I shop at has a big wallbaord up on the
22 wall of the store which has every list and our price
23 right next to it. \$7.98 is \$5.99 right now. And those
24 are coded, so every record, and know what the record is,
25 I pick it up and it has a little sticker on it that has

1 "L" if that is the code and then it says, "\$5.99".

2 COMMISSIONER COULTER: There is a code on the
3 album identifying the list price.

4 THE WITNESS: In the store that I shop at. Yes.

5 COMMISSIONER COULTER: Is that put on by the
6 store?

7 THE WITNESS: Yes. As far as I know.

8 COMMISSIONER JAMES: All right, I want to go
9 back to another thing. One extreme on the one hand, the
10 total cost within the existing cost. On the one hand, if
11 at 48 cents is absorbed in that \$2.79. That is probably
12 ridiculous.

13 THE WITNESS: Yes. There is a 10 per cent increase.

14 COMMISSIONER JAMES: All right.

15 On the other hand, you have shown us what
16 happens if it is absorbed in -- is increased by the 48
17 cents. Based on your wealth of experience in working with
18 this industry, that is 100 per cent past now, what is
19 -- as a consultant, could you come up with as the really
20 average that would probably be a passthrough. Because
21 they are going to absorb some of it. There is some
22 wiggle room in there. What would be the figure based on
23 your background and experience. That actually would,
24 could not be absorbed, would have to be passed through.

25 THE WITNESS: I feel more willing to take a

1 shot at that if the industry wasn't losing as much money as
2 it is.

3 COMMISSIONER JAMES: Well, before 1979, take
4 a shot at it. Ignore that year.

5 THE WITNESS: I would guess, I don't know. It
6 is just off the head guess. I really don't know.

7 COMMISSIONER JAMES: Well, wait a minute now.
8 Maybe 3/4.

9 COMMISSIONER JAMES: 3/4 would be a --

10 THE WITNESS: Passthrough.

11 COMMISSIONER JAMES: Well, I think you ought to
12 be able to give me more than just a guess, now.

13 THE WITNESS: Well, I think there is so many
14 unknown variables on that, I mean, you and I were talking
15 a moment ago about the extent to which some of it would be
16 absorbed in either a slowing of the growth rate of artist
17 royalties payments or in fact an attempt to negotiate
18 them downward.

19 I think that would be an ideal question for
20 Bill Fox or one of the industry people, who clearly would
21 have exact experience on what they do with cost increases.

22 COMMISSIONER JAMES: Let me give you another
23 side of the point. You are here presenting the testimony
24 to try to convince us to keep the royalty rate the same or
25 even reduce it probably. It seems like the record companies

1 would -- would you make that same kind of presentation
2 in their negotiations with the artist? They might have some
3 effect on that.

4 THE WITNESS: Can you elaborate; what do you
5 mean. What kind of effects.

6 COMMISSIONER JAMES: We are not making any money.
7 You are going to put us out of business. We go out of
8 business, nobody makes any money.

9 THE WITNESS: With respect to the artist, you mean?

10 COMMISSIONER JAMES: Yes. We now have got this
11 mechanical increase, all the companies have gone up, et
12 cetera, et cetera; this is what you are getting now. That
13 we just can't maintain any more. See, this is what happens.
14 Present that argument to the artist.

15 THE WITNESS: Uh-huh. Again, I think the
16 risk is -- I think maybe I can -- I think it is a very
17 appealing notion. I just wonder how much -- if you and I
18 were in the record business, and we had Stevie Wonder and
19 we had Billy Joel, and we had Barbra Streisand, and that
20 was our --

21 COMMISSIONER JAMES: And we wanted to keep them.

22 THE WITNESS: And we wanted to keep them.

23 COMMISSIONER JAMES: And we wanted to make money.

24 THE WITNESS: Sure, we wanted to make money.

25 COMMISSIONER JAMES: And the U. S. Government

1 says hey, this is going to be the rate on this one item.

2 THE WITNESS: Sure.

3 COMMISSIONER JAMES: You are with us on that
4 point.

5 THE WITNESS: Fine, now, let's suppose that
6 we also have 4 or 5 other artists who were trying to break
7 because we know it makes sense in this industry to try to
8 have a full line, we know it makes sense to keep turning
9 over, we know artists careers tend to be somewhat ephemeral.
10 So we are not just riding on our past success. Now, I come
11 to you and I say "We got a problem, we are not making any
12 money. Billy and Barbra and Stevie want more."

13 What are we going to do? And it just seems
14 to me that before we rock the boat with them --

15 COMMISSIONER JAMES: I will hire you.

16 THE WITNESS: It seems to me that before
17 we rock the boat with them, we would cut the others,
18 and I think that is what the testimony has shown is
19 happening.

20 COMMISSIONER JAMES: Or cut the rate.

21 THE WITNESS: That's -- we will deal with
22 Barbra if we get pushed to the wall. But gosh, I wouldn't
23 try to do it first. I'll try everything else.

24 COMMISSIONER JAMES: Cut the rates of the other --
25 Mayor Daley, he started off with 12 per cent. Maybe he

1 should have gotten 6.

2 THE WITNESS: Yes; I don't know how much the
3 contractual situation puts constraints on those kinds of
4 re-negotiations. I am not familiar with that, but I would
5 guess we would try everything before we tried to meddle with
6 our stars.

7 CHAIRMAN BURG: Commissioner James -- hold
8 your question until after a five minute break has been taken.

9 (Short recess.)
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1 MR. SHERMAN: Commissioner James, I was just about
2 to remind you of some testimony, since you raised the question
3 of whether you would cut those artists or reduce their royalty
4 rate. When Mr. Cornyn was here, he testified that when they
5 had a problem with Arlo Guthrie, for example, they didn't even
6 consider cutting his royalty rate. That wasn't the problem.
7 The problem was getting over the initial hump of his recording
8 costs and marketing costs. So, that was what they cut, not
9 his royalty rate. And also --

10 MR. GREENMAN: Mr. Sherman, I don't think now is
11 the time for an argument over what the testimony is. If you
12 want to ask Dr. Kiser a question based on testimony, that's
13 proper, but otherwise, I object to Mr. Sherman either arguing
14 the testimony --

15 COMMISSIONER JAMES: I think he's agreeing with
16 you.

17 MR. FITZPATRICK: Were we in the midst of colloquy
18 with Commissioner James, or --

19 CHAIRMAN BURG: He had another question, as I
20 recall.

21 COMMISSIONER JAMES: I'll come back to it.

22 MR. FITZPATRICK: We will proceed.

23 BY MR. FITZPATRICK:

24 Q We'll proceed, Dr. Kiser, with your next chart, if
25 you are ready to go to that, and Commissioner James can ask

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1 the question at a later point.

2 A At the risk of me initiating the discussion, I just
3 want to make two follow-up points, and that is as we work our
4 record company at the Stable of Stars, we face a little bit
5 of a different problem than the auto manufacturer, who if the
6 price of steel goes up, can shift to an aluminum block or
7 something like that. And that is, if Barbara Streisand's
8 demands go up, can we really easily substitute for her? And
9 the answer is, well, yes, there are others we could use, but
10 my word we would be taking one devil of a risk. So, we have
11 a much more difficult problem of substituting for her if her
12 demands go up.

13 Secondly, we know that the number of singer-songwriters
14 is not all that large that are accounting for a very large
15 fraction of sales. I would think these people know each other,
16 have social experiences together, and the like. I wouldn't be
17 a bit surprised if they discussed their royalty levels. And it
18 seems to me --

19 COMMISSIONER JAMES: You couldn't prove it by me the
20 fight we had over getting those contracts into evidence.

21 THE WITNESS: That's because the lawyers are
22 fighting. I'm talking about the artists themselves. I suspect
23 they talk to each other.

24 And it just seems to me that if the mechanical rate
25 goes up like that for all the singer-songwriters that they are

1 going to treat it as a new floor and say, look, everybody else
2 is getting eight percent or six percent or five cents or three
3 cents, or whatever it is. I mean, that's my initial position.
4 That's the bargaining position. I'm not going to negotiate
5 with you. That's what John down the street is getting and
6 that's what Carol down the street is getting, and that's what
7 I intend to get, because they are my peers.

8 COMMISSIONER JAMES: All right. Let's take that one
9 step farther. The rate stays the same. You and I are in
10 business, and Barbara Streisand just keeps turning out those
11 records, and Stevie Wonder keeps coming out with those records,
12 and they keep going up. Somewhere down the line, you and I
13 have to make a decision of where -- if we were enjoying a profit
14 and were putting it in our pockets, ten percent, our take home,
15 and it cuts to five percent, how far do we let it go down
16 before we say, hey, Barbara, we are not able to pay our mort-
17 gage now.

18 THE WITNESS: There's no question that at some point
19 Barbara has to learn that she is affected by the free market
20 the way we all are.

21 COMMISSIONER JAMES: Okay. I am just saying, why
22 can't that be farther down the stage.

23 THE WITNESS: I suspect at some point that the
24 share of sales going to artist royalties will level out. They
25 may already have. It didn't change all that much in the figures

1 that we have here.

2 COMMISSIONER JAMES: Well, a ten-year increase of
3 from 14 to 25 over ten years, that is --

4 THE WITNESS: I don't dispute that change at all.
5 I am saying since '76, it's been oscillating around the 24
6 or 25 market.

7 COMMISSIONER JAMES: I think they may not have drawn
8 that trench, where they have taken a hard line. You know,
9 we're not pushing them out into another record company. Hey,
10 you're getting into our pockets now, and then letting them
11 float up. Would you agree? Because you and I are businessmen.

12 MR. FITZPATRICK: This is your hypothetical, Mr.
13 James, that they hadn't dug the trench?

14 COMMISSIONER JAMES: No, it's hypothetical that we
15 were in business together.

16 MR. FITZPATRICK: Well, I do think it's fair, you
17 have just said it's your view that the record companies haven't
18 dug a trench, and isn't that correct? I'm not sure there's
19 anything in the evidence that is even close to that conclusion.
20 We can argue about that. I am just wondering whether your
21 hypothetical, whether that question you posed is part of your
22 hypothetical or whether you are asking Dr. Kiser to comment
23 whether the evidence in this matter supports your hypothetical.

24 COMMISSIONER JAMES: Let me ask it this way. Dr.
25 Kiser, did you understand my question?

1 THE WITNESS: I think.

2 COMMISSIONER JAMES: Before Mr. Fitzpatrick
3 interrupts.

4 THE WITNESS: I would appreciate a restatement of
5 it.

6 COMMISSIONER JAMES: Let the reporter read it back,
7 then.

8 (The last question was read back by the reporter.)

9 THE WITNESS: As I was saying, we look here at what
10 would be the effect of the six percent mechanical royalty, and
11 we notice illustrated for a \$7.98 record, that first of all,
12 the price to the distributor of the record company went well
13 beyond 50 percent of list, which has been kind of a range in
14 historical terms of what the record company has accepted, and
15 also that the price to the consumer squeezed the discount from
16 the list that he was accustomed to achieving. I think one has
17 to ask the question would this kind of an increase, just this,
18 we're not talking about the increases in vinyl here or anything
19 else, would this prompt an increase in list price? And I think
20 it is a very fair question, and so we wanted to look also at
21 what the impact would be if indeed, now, this \$7.98 record
22 went up to \$8.98, assuming a one-dollar jump in list which has
23 been the practice.

24 CHAIRMAN BURG: Dr. Kiser, let me get into this mix
25 a little bit. If you wanted real bargaining power with the

1 artists, couldn't you, as a practical matter, suggest that
2 instead of waiting until that artist got a percent on the
3 record after it broke even that the percentage might well be
4 lower, but paid from an earlier start; in other words, elim-
5 inating that risk factor that the artist absorbs? Could you
6 not say instead of 25 percent, we will start paying you from
7 the first album, the first unit that is made and distributed
8 as you do with mechanical royalty, but instead of getting 25
9 percent, you will be getting whatever, 10 percent, 12 percent?

10 THE WITNESS: Except that you would still have the
11 sunk costs of recording and promotion, which really, those
12 royalties are recouping for you.

13 CHAIRMAN BURG: I understand that.

14 THE WITNESS: Wouldn't that increase your cost in
15 the beginning? Suppose we spent \$200,000 on both the recording
16 and the promotions expense. So, we're out of pocket \$200,000.
17 Now, if we pay the artist on the per unit right from the start,
18 even at a lower rate, sure, at some point, you are going to do
19 better way out down the line. It is a creative idea, I think.
20 It would certainly be a change in industry practice. I don't
21 know if anyone has tried it or not.

22 CHAIRMAN BURG: I would just think from the stand-
23 point of being the artist, if I have to wait until my record
24 breaks even before I get any money, that would impel me to
25 stick to as high a rate return as I can possibly get, and would

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1 not induce me in any way to be accommodating to the record
2 companies' wanting to decrease my percentage.

3 THE WITNESS: Exactly, especially with the dramatic
4 evidence of how few artists make money anyway.

5 What we have done here is the same kind of analysis
6 that we did over here, only we are now saying, well, gee,
7 suppose that list price here, either because of retailer
8 pressure or record company practices, goes to \$8.98, as a
9 result of the increase in mechanical. And then we say, what
10 happens? And here's the compounding effect of a percentage
11 rate, which I think is important to understand.

12 MR. SHERMAN: If we may interject for the record,
13 Dr. Kiser is referring to what has been marked RIAA Exhibit
14 DD. It is entitled, "Effect of the Six Percent of List Mechan-
15 ical Royalty Rate on the Actual Retail Price of Recordings with
16 \$7.98 List Price Rising to \$8.98".

17 THE WITNESS: Well, now, we go to a little bit of a
18 greater level of complexity. Over here, we have the record
19 company cost of \$3.00, which has been the result of the increase
20 in mechanical of six percent. Now, we are assuming we have to
21 raise list price. The question is, what has our new cost become?
22 Well, first of all, there's an increment of mechanical royalty
23 because the six percent is now applied to \$8.98 instead of
24 \$7.98, and that adds another six cents. So, this \$3.00 goes
25 up six cents.

1 In addition, again for illustrative purposes, most
2 artist royalties are based on list. And the average is about,
3 we're saying here, 25 percent of wholesale, or say, 13 percent
4 of list. So, with an additional dollar on the list price, we
5 also are now having to pay the artist an additional 13 cents,
6 13 percent of the one-dollar addition in list. And there are
7 a lot of other charges that would change according to the list
8 price, which I haven't attempted to take into account, and
9 these include cost of higher AFM payments, cash discounts,
10 customary advertising allowances, and the like, and one of the
11 later witnesses can talk in greater detail about that.

12 So, not only does our \$3.00 cost over here rise
13 by six cents, but I'm counting an additional 13 cents caused
14 by our existing contractual agreements with artists. So, the
15 cost becomes \$3.19. And now, again, we will go through the
16 distribution chain and the amount of mechanical royalty as we
17 begin has now risen to 54 cents from 48 cents, the additional
18 six cents caused by the dollar increase in list. If the
19 record company's margin remains at 30 percent, again, which I
20 believe is very conservative, the price to the distributor
21 would rise to \$4.56. If the distributor's margin remains 18
22 percent, his price to the retailer would rise to \$5.56. Finally,
23 if the retailer's margin remained 16 percent, which I think is
24 very conservative, the price to the consumer would be \$6.62.
25 So, now, we have \$6.62 on top of what used to be \$5.79. And

1 that's an increase of 83 cents an album. So, what looked
2 fairly innocuous becomes a substantial amount per album, for
3 an increase in the consumer price of 14.3 percent.

4 You will note, having moved to the \$8.98 list,
5 this \$6.62, that the consumer pays is now more in a historical
6 relationship to the \$8.98. His discount off list is 26
7 percent, which was comparable to the 27 percent that we had
8 initially. The copyright fee, as a percentage of the price
9 to the consumer and all the way down, is now 16.9 percent.
10 That's the portion due to copyright royalty. And I have made
11 an estimate, based on the number of units of front-line product
12 and some proportional relationships with club and budget albums,
13 and I estimate that this 14.3 percent would cost the consumer
14 approximately 335,000,000, as the point estimate that I came
15 up with, somewhere over \$3,000,000. This is a substantial sum
16 to ask, I think, of a consumer, and a condition here where, as
17 I showed yesterday, the supply of tunes is much more than ample
18 from that which the record companies are using. It's a
19 substantial increase to ask of the consumers for an industry
20 which appears to be in terms here of the copyright owner
21 very, very profitable. It's a substantial amount to ask of
22 the consumer, given that he is strapped, and the level of
23 disposable income in this country has now lagged inflation for
24 what, two years, three years.

25 And I simply point this out as something that has to

1 be taken into account and considered very, very carefully.
2 And likewise, we could go through this analysis for eight
3 percent and five cents. I haven't prepared the charts on
4 that. I thought you would get a little overwhelmed and I would
5 have, too. And the numbers are truly astronomical for the
6 eight percent proposal because of the increases in list that
7 it would trigger. This figure is more on the order of 650
8 to 700 million dollars.

9 BY MR. FITZPATRICK:

10 Q Let us turn, then, if we could, to the last subject
11 that we wanted to speak to. I think we could probably complete
12 before lunch.

13 Won't the effects of a rate increase be blunted by
14 bargaining between the record companies and copyright owners?

15 A I think that's wishful thinking.

16 Q That is the proposition that Dr. Nathan has advanced,
17 that one need not worry about the impact here, because there
18 will be bargaining. You say that is wishful thinking. Do you
19 have any empirical evidence to support your conclusion, Dr.
20 Kiser?

21 A Well, first of all, the same argument was made in
22 1975, when the proposal was to go from two to three cents.
23 There are other proposals, as well. What we saw was the rate
24 went from two to two and three-quarters. In fact, the amount
25 of discounts off the two and three-quarter cent rate declined.
It's very rare, at least in the figures that we've looked at,

1 to find any discounts for medley tunes or short segments of
2 a tune which used to command a lower copyright royalty than
3 a full blank tune would have. And the evidence that I have
4 looked at simply indicates that bargaining or discounting from
5 the rate that you set simply won't occur in any large amount,
6 except for a few standard variations which I will talk about.

7 I would also add that the testimony of Mr. Yetnikoff
8 makes fairly clear that he doesn't think that really any
9 bargaining will take place, because publishers, copyright
10 owners aren't giving him any discounts.

11 MR. ZUCKERMAN: Madam Chairman, so that the record
12 is clear, the proposal to which Dr. Kiser referred was a
13 proposal for an increase from the old rate to four cents, not
14 three cents.

15 THE WITNESS: Thank you.

16 In order to examine this question--it is a very
17 important one, no question about that -- we took a look at two
18 case studies, a very large firm and a small firm. And we
19 looked at a set of figures of all of the royalties that they
20 paid on certain classes of product. Now, we separated that
21 product into three groups.

22 MR. GREENMAN: Excuse me. Is this material some-
23 where in your report, or is this new material?

24 THE WITNESS: I am about to discuss the results of
25 two case studies which are reported on Pages 23 of my April 7th

statement and the following pages.

Now, what we did, we asked a large company and a small company to allow us to look at the rates that they paid for all releases in 1978, every record that they released in the regular price category. When we did that, we were furnished label copies which are their in-house forms which cover 4,786 tunes, of which 4,198 had all the information that we needed, such as the royalty rate on the sheet and the tune time. We made no attempt to find out about the other 588, and it's possible that because of contractual relationships between companies and other label companies that they wouldn't have that information anyway. We then put all this into a computer and figured out what the distribution of rates around various key rates were. And you will note here from the figures that all of those tunes at two and three-quarters, the statutory rate, amounted to just over two-thirds of the sample, 67.6 percent. Eleven percent were still being paid at the two-cent rate, based on licenses struck before 1978, and a various tiny fraction of public domain, and they don't demand any rate. So, we will call them statutory. In addition, 12.6 percent were paid a rate higher than two and three-quarters, because of overtime. So, all those add up to about 92 percent statutory. In addition, there were contracts with artists calling for a situation such as okay, you do an album, we will pay you at ten times statutory. If then, he only had on his album nine

1 tunes, each tune rate would be slightly above two and three-
2 quarters. We had 1.1 percent of our tunes in that category.
3 So, if you look at all the ones that were either statutory or
4 above statutory, it comes to 93 percent. It's a huge fraction.
5 Then, the question was well, what about the other seven percent?
6 And there, we found that of that seven percent, 6.9 percent,
7 virtually all of them, were situations of artist contracts on
8 an album basis. For example, to take my example again, you
9 might have had ten times statutory on an album, and instead of
10 nine tunes the album may have had eleven, so again, the rate
11 was 27-and-a-half cents for the album, but dividing by 11 would
12 give you a rate somewhat below statutory, and that shows up
13 here in this 6.9 percent.

14 So, we point out on the basis of this evidence that
15 it's quite clear that the statutory rate is the guidepost, it's
16 the rate in the vast majority of circumstances, and it ends up
17 being the guidepost or the peg to which all other rates are tied.

18 Another good example of this is the record club rate,
19 which historically, because of the huge distribution of free
20 goods, has been on the order of 75 percent of statutory. And
21 we are using 1975, when the statutory rate goes up, the record
22 club will rise right with it at 75 percent. And sure enough,
23 that's exactly what happened. It rose from a penny and a half
24 which was 75 percent of the old two-cent rate, to 2.06. And
25 that's indicated on the following page, where here we show the

1 record club statistics, page 24 of my April 7 study. And here
2 we see a little more variation, but it tends to be either
3 record club rate or higher. Eight percent, we're at the two
4 and three-quarter cent rate, 7.3 percent, we're at the two
5 cent rate, which was the pre-78 statutory rate. And three
6 percent here were public domain. Counting that as statutory,
7 we have just under 19 percent for statutory, even in the record
8 club area. But we know that the large pattern of record club
9 rates are a standard 75 percent of statutory rate. And you
10 see those clustered in the record club discount line where
11 nearly three-quarters of all of rates fell.

12 Of the tunes that were -- all the tunes that were in
13 the 73.9, the vast majority, over -- just eyeballing it, 97
14 percent of those tunes were three-quarter rate. Ten were at
15 half the rate. We have what looks to be one album which was
16 at half the rate. And finally, we had three percent of the
17 tunes earning a standard overtime statutory rate. So, again,
18 we see that the rule rather than the bargaining, if any, that's
19 going on here is certainly not a rule under any stretch of the
20 imagination.

21 COMMISSIONER JAMES: Dr. Kiser, can I interrupt you?

22 THE WITNESS: Yes.

23 COMMISSIONER JAMES: All right. This isn't one of
24 the factors that you have taken into consideration. And I
25 think this is the best illustration I have ever heard of. If

1 you have a hungry dog who hasn't eaten in seven days and you
2 put a piece of steak in front of him and say "sit", isn't that
3 the analogy that we have here, that for 60 years they were at
4 a rate, and then it was kicked up a little bit. Now, you want
5 to say sit, don't go.

6 THE WITNESS: I'm having a little trouble with your
7 analogy, because I trained my dog long ago to sit, no matter
8 what, or my house would be a shambles.

9 COMMISSIONER JAMES: Well, if he hasn't eaten for
10 six days and you put a steak in front of him and tell him to
11 sit.

12 THE WITNESS: I don't have any evidence put forth
13 to me that the earnings of the copyright owners are suffering.
14 It is true. And I know that it's counter-intuitive that the
15 rate has been at a low level relatively, if you want to call
16 it that. It has been at a level, certainly, for what, 60
17 some-odd years, it was at the same level. Two and three-
18 quarters, I think kind of common sense tells you gee, that
19 doesn't seem like very much from two, but that's an enormous
20 increase multiplied by all the records.

21 COMMISSIONER JAMES: I agree.

22 THE WITNESS: All the figures that we have seen
23 demonstrate that very attractive returns are being earned at
24 that rate. So, I don't know how hungry the dog is.

25 COMMISSIONER JAMES: Okay.

1 BY MR. FITZPATRICK:

2 Q Looking at Chart K, of the singer-songwriters that
3 were earning amounts of money --

4 MR. GREENMAN: Chart K?

5 MR. FITZPATRICK: Chart K was the Warner Brothers
6 data that showed the singer-songwriter income in 1979.

7 BY MR. FITZPATRICK:

8 Q That might be the salty dogs. Would you consider
9 those particular singer-songwriters, would those amounts of
10 money paid indicate under-payments or starvation wages for dogs
11 or singers?

12 MR. ABRAM: Madam Chairman, may I approach a point
13 I'm trying to get clear. Is that a chart that resulted from
14 the Warner Company response alone or all of the companies of
15 which the inquiry was put?

16 MR. FITZPATRICK: No, I believe this is a Warner
17 chart that's been in evidence and been referred to repeatedly.

18 MR. ABRAM: But is it a Warner chart and only a
19 Warner chart and contains only the Warner responses?

20 MR. FITZPATRICK: Oh, yes. I think that's been
21 very clearly set forth on the record.

22 MR. ABRAM: I'm trying to get clear. I really would
23 like to get clear.

24 MR. FITZPATRICK: Excuse me. I'm sorry.

25 MR. ABRAM: Were there the same inquiries put by

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1 Dr. Kiser, through Cambridge, to all the other companies
2 including Warner?

3 THE WITNESS: No, I had nothing to do with this
4 chart.

5 MR. ABRAM: So, this is not of your making?

6 THE WITNESS: That's correct.

7 MR. FITZPATRICK: It's a Warner Brothers record
8 chart.

9 MR. ABRAM: Well, in your financial survey -- I
10 don't want to at this time engage in controversy -- Item 6
11 says, "Section D personnel please estimate the percentage of
12 mechanical fees paid to singer-songwriters and indicate the
13 basis of your estimate. Now, that's the predicate for infor-
14 mation in that chart?

15 THE WITNESS: It would be similar in type, but we
16 did not ask our respondents for any dollar magnitude of mechan-
17 icals.

18 MR. ABRAM: Do you have, and this is what I'm trying
19 to find out, the responses of other companies to Item 6, which
20 I have just read out?

21 THE WITNESS: Yes, I read them into the record
22 yesterday, in terms of weighted responses, and I went on in
23 some length that I --

24 MR. ABRAM: They are lower --

25 MR. SHERMAN: Will you let him finish?

1 THE WITNESS: And I went on at some length that I
2 had some reservations about weighting figures such as those
3 by sales, because I couldn't be certain that the basis of
4 developing those figures was comparable to company to company.

5 MR. ABRAM: Same objections cubed to this evidence.

6 MR. FITZPATRICK: I made reference to this to illus-
7 trate the hungry dog thesis, the Alpo question.

8 COMMISSIONER JAMES: I said steak.

9 MR. FITZPATRICK: The only point that I wanted to
10 use this for --

11 BY MR. FITZPATRICK:

12 Q Well, go ahead. I think, Dr. Kiser, that you com-
13 pleted your discussion in terms of the empirical evidence that
14 you looked to to reach the conclusion that there wouldn't be
15 any bargaining?

16 A Well, we also asked, because we were somewhat more
17 interested in figures of all our respondents, as well as our
18 in-depth case studies of two, we also asked in Section H of
19 our survey for information on mechanical royalty payments.
20 And we recorded figures on Page 11, of the April 7 study,
21 dealing with those results.

22 And here again, we see a confirmation of the very
23 same point, that when we took the responses of the individual
24 companies and weighted them by sales, 95 percent of the first
25 line LP releases were paid a two and three-quarter cents. 98

1 percent of the singles were paid at two and three-quarter
2 cents, the statutory rate. 87 percent of overtime tunes were
3 paid at the overtime statutory rate of a half-cent per minute
4 or fraction thereof. I would assume that the others were either
5 not paid by artist-interest packages, but I don't know.

6 We asked for the usual mechanical royalty per tune on
7 "best of" and "hits of" albums. Everyone indicated two and
8 three-quarters cents, I believe. And here is an area where we
9 would expect a discount, if any.

10 MR. ZUCKERMAN: Madam Chairman, here is also an area
11 where the failure to specify the record company respondents
12 makes it impossible for us to cross examine, because the "best
13 of" and "hits of" practices differ between different record
14 companies, as we pointed out in our reply to Dr. Kiser's study.

15 CHAIRMAN BURG: So noted.

16 THE WITNESS: Turning the page over to Page 12, we
17 asked the companies for the usual mechanical royalty per tune
18 on record club releases, and the usual answer was 75 percent.
19 One company indicated 50 percent. We asked for the usual
20 mechanical royalty per tune on budget and economy recordings,
21 which historically have had a level of some discount. And we
22 got 75 percent of the statutory rate or half of the rate.
23 And we asked for the usual mechanical royalty per tune on
24 classical recordings, where you have a lot of overtime, and the
25 rate was either two and three-quarters or a half-cent per minute.

1 So, I offer that evidence to you simply to make the point that
2 certainly the increase offered in 1978 did not increase any
3 bargaining that took place, and certainly not on a tune-by-
4 tune basis. And why we see rates that come in below statutory
5 in our opinion can be explained rather easily by looking at the
6 strata of these rates, especially the artist-interest packages,
7 which can create some individual tune rates below the statutory
8 rate, and other strata like record club and budget. So, here
9 it makes no sense to report an average mechanical rate when
10 one understands full well what the existing practices of the
11 industry are.

12 BY MR. FITZPATRICK:

13 Q Finally, in terms of encourageable evidence, was
14 there anything that you've seen in the record that would indi-
15 cate what the publishers would do if they were given a six
16 percent rate?

17 A Well, the one piece of testimony that jumped out at
18 me was when Mr. Robinson was asked if the rate goes to six
19 percent, what will you charge. And he said six percent.

20 Q Does the statute give you any guidance here in terms
21 of the question of bargaining?

22 MR. ZUCKERMAN: Objection. That's a legal question.

23 MR. FITZPATRICK: Well, I would like to have him
24 answer. If the Tribunal thinks that the answer is trenching
25 on lawyers' domain, then we don't want Dr. Kiser to do that.

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1 I would think that from his point of view, in terms of trying
2 to observe the criteria and observe the responsibilities here
3 from an economist's point of view, and if there is a question
4 of a legal judgment, we will agree with counsel to strike the
5 point.

6 COMMISSIONER GARCIA: Would you repeat the question
7 for me?

8 MR. FITZPATRICK: Yes. I said, does the statute give
9 you any guidance in terms of the question of bargaining.

10 Let me restate it.

11 BY MR. FITZPATRICK:

12 Q In reviewing the criteria, is it your view that the
13 Tribunal is directed to set a rate?

14 A Yes, there's nothing in the criteria that has anything
15 to do with bargaining.

16 Q All right. Now, is bargaining practical, from your
17 point of view, Dr. Kiser?

18 A Well, it seems to me that the previous testimony
19 has illustrated that there are a number of problems with
20 adopting a system of bargaining. One of those is that the
21 recording precedes frequently the licensing of the tune
22 itself. I think Mr. Gortikov testified that composing some-
23 times takes place during the recording session. It would be
24 rather difficult to be deciding on the price at that moment.

25 Third, I don't understand why one would put price in

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1 the creative equation at all. It seems to me that the industry
2 has worked well by not having price in the creative equation
3 and by allowing a selection of music to be dominated by
4 creative choices. And I don't really believe --

5 COMMISSIONER COULTER: Could you expand on that?

6 THE WITNESS: Well, I just wonder how one would go
7 about persuading Barbara Streisand to record a certain tune
8 and working with her to select that music --

9 COMMISSIONER COULTER: By how much it costs?

10 THE WITNESS: Eventually that, right. And her
11 feeling good about the album, the way it's coming together,
12 the music that's been selected. And then you say okay, stop,
13 don't record it yet, I've got to run out and see if I can get
14 a discount. I don't think that's going to happen. It's not
15 going to happen at all.

16 COMMISSIONER GARCIA: Dr. Kiser, do you think that's
17 not going to happen, because at this point it's not significant?

18 THE WITNESS: No, I don't think it's going to happen
19 because that isn't the way to work with Barbara Streisand.

20 And, in any event, I don't believe, as these figures
21 show, and as previous surveys have shown, that any tune-by-tune
22 bargaining will transpire. I think the practical, or I should
23 say the impracticalities of that simply mitigate against it
24 and that businessmen usually adopt patterns of behavior and
25 rules of behavior to make their lives as simple as possible,
to remove complexities where they can be removed, to gain

1 efficiencies. It just isn't going to happen on a tune-by-tune
2 basis. And my understanding, while I made no study of it, is
3 that it doesn't happen on a tune-by-tune basis anywhere in
4 the world.

5 BY MR. FITZPATRICK:

6 Q No matter what the system is or no matter what the
7 rates are, you don't have tune-by-tune bargaining?

8 A That's my understanding.

9 COMMISSIONER JAMES: Did you read Dr. Butler's
10 testimony?

11 THE WITNESS: Yes, I did.

12 COMMISSIONER JAMES: Have you reviewed his chart?

13 THE WITNESS: I didn't have the charts. I had the
14 transcript, but I didn't have the chart.

15 COMMISSIONER JAMES: Do you have a chart, counselor?
16 I want to go to that chart.

17 MR. FITZPATRICK: The answer is no, we don't. We
18 will secure it at lunchtime.

19 COMMISSIONER JAMES: Okay. I will ask the question
20 without the chart.

21 Dr. Butler testified that there comes a point in
22 time where the producer and the artist get together to go over
23 the materials. And they make some selections of what tunes they
24 are going to put on an album before they walk into the studio.
25 Taking Barbara Streisand as an example -- she doesn't write any

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1 of her music?

2 THE WITNESS: I think she may have participated
3 in her hit, "Evergreen", but I'm not certain.

4 COMMISSIONER JAMES: All right. Except for that
5 one song, generally, Barbara Streisand does not like to sing
6 her own music?

7 THE WITNESS: That's my understanding.

8 COMMISSIONER JAMES: All right. If they have a
9 selection of 20 tunes that they are thinking about going into
10 the studio to make a recording on, isn't that a point in time
11 where some negotiations can go on, very meaningful negotiations?
12 For instance, they could call a publisher and say we are
13 considering putting your tune in one of Barbara Streisand's
14 new albums.

15 THE WITNESS: Would you tell her no, if the publisher
16 wouldn't give you a discount?

17 COMMISSIONER JAMES: You could say to the publisher
18 if you don't, there's 20 tunes, the final selection hasn't been
19 made yet. The publisher says, "I want the statutory", and you
20 can say, "Well, we've got 19 others we can deal with, you're
21 out." Aren't you in a better bargaining position before the
22 record is cut, before you walk in the studio?

23 THE WITNESS: I don't know if that's indicative
24 of the actual practice.

25 COMMISSIONER JAMES: It doesn't happen, generally,

1 but couldn't it happen? If you look at Dr. Butler's flow
2 chart, he says the producer and artist get together, they go
3 over the material. So, it does happen, at least at Columbia
4 or CBS.

5 THE WITNESS: Oh, I'm sure they go over the material.
6 I'm just wondering whether they go to the trouble of selecting
7 20 tunes before they start.

8 COMMISSIONER JAMES: What does "material" mean?

9 THE WITNESS: Well, why would we be spending the
10 time and energy to get Barbara Streisand to agree to do 20
11 when we were doing one album, and the chances that we are going
12 to have only 10 or thereabouts, would we really --

13 COMMISSIONER JAMES: I'm just using 20 as the number.
14 I doubt very seriously you would pick all 10 tunes, but at
15 least -- take your example, then. All 10 tunes are pre-selected
16 before you go in the studio. Don't you have bargaining there?

17 THE WITNESS: I think the question is, to what
18 extent do you have a substitute. It seems to me that, as
19 Mr. Yetnikoff testified, they are working on a final product.
20 They may have done some of the recording already. The issue
21 is, how does Barbara feel about that tune, how is it going to
22 come out, what's the performance going to be like? Nobody
23 knows the value of that tune before it's sold. If you were the
24 publisher and I were the record company, you would have your
25 hunch about what that tunes is worth and I would have my hunch.

1 And we could negotiate like that, I suppose. But we don't
2 know, we don't know what the value of that tune is, because
3 the value is going to be in part, to a large part, determined
4 by the nature of the performance. So, we're in the position
5 of trying to make a deal on prices before we know what we have.

6 COMMISSIONER JAMES: Take the existing situation
7 right now. That record gets .275, right? You don't know the
8 value of what's going to happen down the line?

9 THE WITNESS: That's because the rate has been set.

10 COMMISSIONER JAMES: All right. Now, you still have
11 bargaining room there, wouldn't you, under the existing system?
12 If you know you are going to have a song and you know you are
13 going to have to pay .275, and you know the song before you
14 walk in the studio, you know the max you're going to have to
15 pay anyway. Isn't it incumbent upon you to try to get a lower
16 rate before you cut the first tune?

17 THE WITNESS: Let me explain why, in economic terms,
18 I don't think it works.

19 COMMISSIONER JAMES: All right.

20 THE WITNESS: Suppose I'm the music publisher and
21 you come to me and say Barbara Streisand is about to record
22 your tune and I want two and a quarter cents. Now, the issue
23 is this. I think wow, I'd love to have Barbara Streisand
24 record my tune.

25 COMMISSIONER JAMES: You're the publisher?

1 THE WITNESS: Yes. And I'd love to have her record
2 my tune, there's no question about it. And I have to think,
3 all right, are you going to say well, I'm going to substitute
4 another tune if you don't get the two and a quarter or two
5 and a half or whatever discount you are seeking, so that I
6 have some risk in saying no. And what we've just been saying
7 is that I don't really think that.

8 COMMISSIONER JAMES: That's bad negotiation, though,
9 isn't it?

10 THE WITNESS: Hold on. I'm not negotiating yet.
11 I'm just thinking in my head.

12 COMMISSIONER JAMES: On my part, if I came and
13 presented a proposition like that to you, that would be very
14 bad negotiation on my part.

15 THE WITNESS: You mean if you made an offer in price?

16 COMMISSIONER JAMES: No, if I said that gee, Barbara
17 Streisand wants to record your particular tune.

18 THE WITNESS: Well, if you came to me and said how
19 about a discount, I'm sure I'd say how are you going to use it?
20 And you say on an album.

21 COMMISSIONER JAMES: With Barbara Streisand.

22 THE WITNESS: Yes. Then I know.

23 COMMISSIONER JAMES: Okay. But you said wow,
24 Barbara Streisand wants to --

25 THE WITNESS: Okay. I'm making two points. The

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1 first one is that I don't know how much there's a substitution
2 effect at the point where negotiation would occur, because
3 of the nature of the recording process, and the industry people
4 can certainly talk in greater depth than I can about that.
5 That's been the testimony to date.

6 The second point is let's look at the economics
7 from the publisher's point of view. You're asking him to
8 take a discount on a rate. Now, most businessmen cut price
9 because they expect it to have some effect on volume. They
10 don't cut price just because they want to. Everybody wants
11 the price fully if they can. Now, you're saying the publisher
12 cut the price. And if he's a rational person, and I assume
13 they are, he must ask himself, and this is for front-line
14 profit, now, if I offer or agree to a lower price, am I going
15 to get any impact farther down the road, is the record company's
16 price going to be that much lower? And I say no. Even if the
17 mechanical royalty rate is ten cents less on the album, all
18 the way down the line, is the consumer going to feel that, is
19 the eventual volume of a record that's sold in a marketplace
20 going to be higher because I make this decision? The answer
21 is no, that's not going to be perceptible. Not because it's
22 such a small amount, because even if he made a rate 50 cents,
23 75 cents, you're still going to be in a position of a consumer
24 going into the record store to buy Barbara Streisand's album
25 and the fact that it's \$6.50 versus some other record that might

1 be six, I don't believe is going to change your mind. What
2 we're talking about here is, in economic jargon, is the price
3 elasticity of the man to the publisher changing his rates.
4 And as a rational managerial economist, he has no incentive
5 to do so. He's going to slash his profits in half by taking
6 a lower rate, if the discount is a half, but he's not going
7 to get a compensating increase in volume. And I think that's
8 the principal reason why discounts don't occur. Now, why do
9 any occur, apart from these artist deals that we have talked
10 about? Because certain albums have an enormous range of
11 substitution. If I'm doing a special, a special album on
12 big band sounds of the Forties, I've got hundreds of tunes to
13 choose from. If I'm doing a special hits of love songs of the
14 Fifties, I've got hundreds of tunes to choose from. There, I
15 can understand why the publisher would have a real risk think-
16 ing well, if I don't go along with this, I'm not going to get
17 my tune on the album. It would make sense to do so. But on
18 front-line product, I just don't see why. I would never do it.
19 If he says oh, I've got another publisher who will, I'd say
20 well then, you better deal with him. Because I have to assume
21 that my competitor, my horizontal competitor, is as sensible as
22 I am, and that that pattern won't last for long. And that's
23 exactly what you see, and where you have singer-songwriters-
24 publishers, the answer is never. Stevie Wonder doesn't have
25 to take a discount ever.

1 COMMISSIONER JAMES: I agree there.

2 THE WITNESS: Stevie Wonder doesn't have to take
3 a discount ever.

4 COMMISSIONER COULTER: Can I ask a question? In
5 that instance you feel that the publisher is correct in his
6 reason?

7 THE WITNESS: Not to discount?

8 COMMISSIONER COULTER: Yes..

9 THE WITNESS: Sure.

10 COMMISSIONER COULTER: I believe the reasons you
11 gave were that he felt that the impact would be relatively
12 slight on the price and whatever impact it did have wouldn't
13 affect demand; is that correct?

14 THE WITNESS: Well, I'm sure there would be some
15 effect. I don't think that the -- you might get a slight
16 increase in volume because Barbara Streisand went out to the
17 consumer on an average basis at around \$5.00, rather than
18 \$5.50, or something like that. But I don't see rationally
19 why the publisher would expect that the increase in volume
20 or the decrease in volume would offset the enormous impact on
21 the price he's charging. So, in other words, if the discount
22 was 30 percent lower, would he get a 30 percent increase in
23 volume because of it? You can't say that.

24 COMMISSIONER COULTER: You don't think so. And you
25 think it's correct.

1 THE WITNESS: Yes, I think it's a very sensible
2 thing for him to do.

3 COMMISSIONER COULTER: Now, you've just presented
4 an argument in the contract bargaining suggesting that a
5 raise in the royalty would have a dramatic impact in the
6 opposite direction, isn't that true?

7 THE WITNESS: No, because in the former, we're
8 talking about one album, and in the latter, we're talking
9 about across the board. So, all the money that all the
10 consumers in America have set aside for records is going to
11 go for fewer records, or they're going to have to increase
12 the amount that they are going to spend on them. So, there's
13 a big difference between the individual decision-maker pricing
14 one album and his tunes on one album and the effect of an
15 across-the-board increase in rates on everything. And I
16 think it will be on everything and that the structure will
17 move up.

18 COMMISSIONER COULTER: I recognize that. But would
19 you say, nevertheless, that with certain albums the demand,
20 even given an increase in the price, would be relatively
21 inelastic among certain albums?

22 THE WITNESS: Oh, gosh, I suppose "Saturday Night
23 Fever" had some price elasticity when it was big.

24 COMMISSIONER COULTER: I said inelasticity, my
25 meaning the demand would remain the same even if you increased

1 the price.

2 THE WITNESS: No, I know. I'm saying even a boom
3 seller like "Saturday Night Fever" probably would have sold
4 a total number of units somewhat less than it sold had it been
5 priced a dollar or two higher. I don't know.

6 COMMISSIONER COULTER: But it wouldn't have been
7 significant?

8 THE WITNESS: I don't think so. It still would have
9 been a very big seller, there's no question about that. But
10 if you priced it at \$25.00 an album, I'm sure -- I don't know
11 what the elasticity is, but I'm sure there would have been an
12 effect to operating.

13 MR. FITZPATRICK: I have a few concluding questions.
14 If you want to break --

15 CHAIRMAN BURG: Let's go ahead with it.

16 BY MR. FITZPATRICK:

17 Q I think, Dr. Kiser, with this last colloquy with
18 Mr. Coulter and Mr. James, we probably exhausted the bargaining
19 subject, unless you had anything further to say on that.

20 A No, I think not.

21 Q Well then, one last question. We covered a lot of
22 ground here on a number of different subjects. Could you,
23 Dr. Kiser, in conclusion, recap for the Tribunal briefly the
24 simple points that you'd like to leave them with.

25 A Sure. It does seem like it's been a while.

1 Yesterday, we talked about the -- what appears to
2 be a supply imbalance between the number of musical compositions
3 and the number of sound recordings. We noticed that the
4 musical compositions supply was rising and the recording release
5 numbers were falling. And from a straight analysis of supply
6 and demand, one has to conclude that the present rate is
7 sufficient to induce songwriters to produce compositions far
8 beyond that which can be used in sound recordings. No increase
9 in rate from that perspective makes economic sense.

10 Secondly, the classical economist would turn around
11 and say, well, not only is that price sufficient to induce
12 supply to the extent the industry needs it, but if songwriters
13 are willing to produce at that rate, it must be a fair return.
14 I made the point further that when one analyzes the aggregate
15 financial statistics of not only the recording companies, but
16 also the publishing companies, one finds that the risks and
17 returns are out of balance. This is an uneconomic situation.
18 Over the long-run, it must correct itself. And we looked at
19 some of the forces that were operating on the copyright owners'
20 returns, and we concluded that their level of return was high
21 but that the forces acting on it were ones that would take
22 effect only over slow and lengthy time periods. We looked at
23 the forces operating on the recording industry returns and
24 we noticed that they were certainly paltry by comparison with
25 fortune 500 companies over the period relevant here in our

1 study.

2 So, the risks and returns of the two parties don't
3 make economic sense, the recording companies which take higher
4 risks are earning a lower return, the copyright owners who
5 take lower risks are earning a higher return from the evidence
6 that we have put forth.

7 Thirdly, I made the point that inflation alone can-
8 not be the reason for adjusting the rate in a vacuum, that
9 the effects of inflation -- most economists ignore the effects
10 of inflation most of the time, at least microeconomists. But
11 the effects of inflation can surely only be addressed by
12 including within your analysis of it the effects of volume,
13 the effects of the falling number of releases, some kind of
14 disaggregation for the songwriter population as a whole. I
15 did acknowledge that inflation is a serious problem and that
16 it was certainly legitimate for you to take it into account.
17 I simply make a plea that it's not a superficial abstraction
18 in terms of the declining value of the dollar, but rather it's
19 a relationship that is tied together with the other variables
20 that I mentioned.

21 This morning, we talked briefly about the fact that
22 there really isn't one historical effective rate. It's a
23 concept, I think, which is kind of grasping at straws for the
24 bench mark on how to settle a percentage rate. Our figures
25 show that mechanicals as a percent of list price over that

1 period peaked around 5.2, and that was only in the one time
2 period that I looked at. And to go to six percent, on that
3 basis, seems to me a fairly judicious method of rounding.

4 Also today, we have looked at the impact of this
5 increase, and we looked at the effect of the increase not only
6 on prices as they -- or albums as they are currently priced,
7 but we noticed there was a compounding effect that would take
8 place if the historical relationships of discounting and
9 list the wholesale and all the other price relationships
10 and distribution structure were maintained. When one took that
11 into account, as well, that the cost to consumers could reach
12 \$300,000,000, thereabouts, on a pass-through which was based
13 on assuming that all the distributors and the record companies
14 maintained their margins. I pointed out also that those
15 margins were conservatively estimated and my guess is they are
16 significantly higher at the retail end, and I pointed out that
17 the one I use at the record company end is historically low
18 by comparison, and if the historical margin of 35 percent had
19 been used and at retail more on the order of 20 or 25 percent
20 had been used, the numbers would have been far higher.

21 We also discussed at some length bargaining. It's
22 an appealing notion, we'd like things to be bargained in some
23 way. I don't think bargaining in this circumstance is a
24 viable basis on which to set the rate. I think it's an extra-
25 ordinary risk to the consumer to base the rate on an assumption

1 that there's no problem, it will be bargained away. Not only
2 did we use the evidence that we have to justify that, statements
3 of the publishers themselves who will not bargain, change in
4 the price that occurred from '76 to '78, which showed no
5 bargaining, but a full pass-through of the whole structure,
6 and finally basic economic analysis which shows that the
7 publisher has very little incentive to bargain and would be
8 acting irrationally if he did.

9 So, I think those are the major points. I would
10 just add one. It's not a part of economic analysis. But there
11 has been testimony both from me and from others on the dominance
12 of singer-songwriters who are very well off, and just speaking
13 personally, I wonder, as a social policy, whether another large
14 transfer of income from consumers to these particular people
15 is in the best interest of the country, of the industry, even
16 the other parties around the room who are all affected by that.
17 But I don't offer any view on that from an economist's stand-
18 point.

19 MR. FITZPATRICK: Thank you, Dr. Kiser.

20 CHAIRMAN BURG: We will recess until 2 o'clock this
21 afternoon.

22 (Whereupon, the luncheon recess began at 12:40 p.m.)
23
24
25

A F T E R N O O N S E S S I O N

CHAIRMAN BURG: We will reconvene. Mr. Greenman.

MR. GREENMAN: Madam Chairman, I wanted to make a request under Section 301.16 of the Tribunal's rules of procedure.

(Discussion off the record.)

MR. GREENMAN: This is the one concerning closed meetings. That at some point during the cross examination of Dr. Kiser, we will probably want to introduce portions and questions with respect to provisions in the CBS contracts that have been turned over yesterday. One of the things discussed with Mr. Cohen at the time, as I see it, it will probably require a closed session unless Mr. Cohen deems the matter not confidential.

And I am therefore suggesting at this time that we will -- when that point is reached in the cross -- ask the session be closed, unless Mr. Cohen says it is not necessary. It will only be, I imagine, what, I can't say how long a period of time it would be, but I should think it would not be very long. Now half a day, certainly.

But as I understand it, it will require a vote of the Commissioners prior to that and the filing of the notices that same day. I cannot say whether we would get it tomorrow or Tuesday.

1 (Discussion off the record.)

2 MR. GREENMAN: Right, I don't anticipate it
3 this afternoon. And I -- if I reach it, because of the
4 shortness of time, I think I would just go around --

5 COMMISSIONER JAMES: Counsel, do you plan
6 to put that in writing? Your request?

7 MR. GREENMAN: I was hoping not to have to.
8 Do I have to? I don't have much in the way of stenographic
9 facilities. No problem.

10 COMMISSIONER JAMES: I know it isn't required.
11 It wasn't expected. He has answered my question.

12 CHAIRMAN BURG: Go ahead.

13 COMMISSIONER JAMES: All right.

14 CHAIRMAN BURG: Did you raise your arm?

15 All right, fine, thank you. Let me see.

16 Commissioner Brennan, I will defer to you.

17 COMMISSIONER BRENNAN: I request that there
18 be made part of the record of this proceeding, a document
19 of the Library of Congress Legislative Reference Service,
20 on the subject of the Mechanical Royalty Rate on Sound
21 Recordings, prepared by Edward Knight and dated June 30,
22 1969.

23 CHAIRMAN BURG: So ordered, Commissioner.

24 COMMISSIONER BRENNAN: Dr. Kiser, I would
25 like to read to you a few excerpts from Mr. Knight's

1 report and from time to time ask you to comment on these
2 excerpts.

3 Commencing on page 89, second full paragraph.

4 "There is no escaping the fact that the central issue in the
5 mechanical royalty rate controversy is the question of
6 adequacy of the royalty rate. If the Congress should decide
7 to expand the range of bargaining as urged by the music
8 publishers, it will in effect be sanctioning a change
9 which will have a direct bearing on the finances of both
10 the record producers and the music publishers. In the eyes
11 of the record producers, such a development would involve
12 increased costs to the music publishers. Such a step would
13 mean increased revenue. Given these conflicting objectives,
14 and the fact that the Congress is currently placed in the
15 position of being the arbiter in this dispute over the
16 royalty rate, it stands to reason that the Congress should
17 be given access to the type of financial information which
18 will enable it to gain an approximate understanding of the
19 relative financial position of the music publishers and
20 the record producers before it renders a final judgment
21 on the mechanical royalty rate question."

22 Dr. Kiser, in your opinion, does it also
23 stand to reason that the Copyright Royalty Tribunal should
24 be given similar access to financial information concerning
25 the music publishers and record producers?

1 THE WITNESS: I would say even more so
2 given that the criteria by which the Tribunal must make
3 a judgment are even more specific than any that may or
4 may not have been analyzed by Congress at the time that
5 this was prepared. I would also add though, that I think
6 it was the qualification in that sentence that Congress
7 should be given access to the type of financial information
8 which will enable it to "gain an approximate understanding
9 of the relative financial position".

10 COMMISSIONER JAMES: Commissioner, could you
11 explain who Mr. Knight is?

12 COMMISSIONER BRENNAN: Yes, I would be glad to.
13 Mr. Knight is still -- to my personal knowledge -- employed
14 by the Library of Congress because I had a very difficult
15 time locating him. A copy of the Knight Report and I
16 could think of only two possible sources, one is Mr. Knight,
17 the other Mr. Feist, and I thought that perhaps it would
18 be unseemly to make this request of Mr. Feist even though
19 I, over the years, added and filled the gaps in his
20 collection of prepared materials.

21 (Laughter.)

22 COMMISSIONER BRENNAN: Mr. Knight is -- was
23 an analyst in the Economics Division of the Library of
24 Congress.

25 COMMISSIONER JAMES: And prepared the report for?

1 COMMISSIONER BRENNAN: Prepared the report
2 for the Congress at the request of the Chairman of the
3 Senate Subcommittee on Patents, Trademarks, and Copyrights,
4 and pursuant to my earlier request, the entire report has
5 now been made part of the record, so we will not have any
6 arguments later on as to allegations of selective quotations
7 from the report.

8 COMMISSIONER JAMES: You will furnish copies
9 of course?

10 COMMISSIONER BRENNAN: Commissioner, I was
11 anticipating your making that suggestion. And I also
12 prepared my answer. Because I was hoping that you would
13 make the request and so therefore, I am sure you will ask
14 your secretary to reproduce the copies for the Commissioners.

15 (Laughter.)

16 COMMISSIONER BRENNAN: Dr. Kiser, continuing
17 on the same page, Mr. Knight then went on to in summary
18 fashion discuss what he perceived to be certain deficiencies
19 in Dr. Glover's study and his sampling techniques; and I
20 made brief reference to that yesterday.

21 There then appears the following sentence.

22 "On the other hand, the music publishers to date as a body,
23 have refrained from furnishing the Congress any meaningful
24 economic data on their activities."

25 Would you assess the state of our record as to

1 the economic data supplied to us by or on behalf of the
2 music publishers?

3 THE WITNESS: I think it is completely inadequate.
4 For one, as an analyst, I am in an awkward position, because
5 I have to make a number of estimates based on the most
6 scanty of information, so I feel that personally, but from
7 a point of view of sympathy with the Tribunal, I honestly
8 don't know how one can make a judgment about relative
9 returns, relative financial position and the impact of
10 various proposals on that position, without such information.

11 It seems to me that we could chat about what
12 that kind of information might be, as well, but I will
13 stop there.

14 COMMISSIONER BRENNAN: We will come to that
15 in a half an hour or so. It has been suggested recently
16 that perhaps this gap in our economic data has been filled
17 by Dr. Renfret's study. And that possibly the composers
18 are your real adversaries. Could you address yourself
19 to that argument?

20 THE WITNESS: I don't feel I have any adver-
21 saries. Your time will come. I don't buy that. I know that
22 that has been offered, the opportunity to work with the
23 raw questionnaires and develop all the cross tabs that
24 must make it meaningful to -- I don't have the time to do
25 that. Nor should it be the obligation of others to do that.

1 I think by the very nature of the Renfret data,
2 one has a serious question about how useful it is in the
3 sense of the enormous amount of part time people. If we had
4 any way at all of simply separating out some of those
5 figures, to get the part time people set as a separate
6 class, and examine the characteristics of their financial
7 profile, as Dr. Renfret called it, for that class, I
8 think it would have been far more useful. We did not
9 have that opportunity.

10 COMMISSIONER BRENNAN: Turning now to the
11 portion of Knight's report, which is described as concluding
12 observations commencing on page 97. Mr. Knight concludes,
13 referring now to the music publishers, they "have
14 demonstrated a clear reluctance to provide the Congress
15 with the type of financial information that will be needed
16 to evaluate their position."

17 He then goes on to suggest in general terms
18 the areas in which financial information should be sought,
19 by the Congress, and he offers to the Congress various
20 mechanisms, devices, by which this information could be
21 sought.

22 One of these set forth on page 98 is as follows:
23 "The establishment of an independent ad hoc study group by
24 the Congress." I translate that to read Copyright Royalty
25 Tribunal. Do you agree on my translation?

1 THE WITNESS: If you want to consider yourself
2 an ad hoc study group, that's all right with me.

3 COMMISSIONER BRENNAN: Since this proceeding
4 does not resume until 1987, I think we could accept the
5 term ad hoc.

6 We all know, and the record clearly establishes,
7 that there have been significant changes in the traditional
8 role of the music publisher in relation both to the record
9 producers and also to the composers. It might be argued
10 that because of these changes in the music industry,
11 that access to financial information no longer is quite
12 so relevant.

13 Mr. Knight was very perceptive and he addressed
14 this issue in his report. I will read his concluding
15 remarks, which appear on page 90, and then ask for your --
16 page 90.

17 "It must also be recognized that the changes
18 in the structure of the music recording business in recent
19 years, particularly the mergers and other forms of
20 intervening that have taken place between publishers and
21 record producers, as described in part 1 of this study,
22 seriously complicate the decision that Congress is
23 called upon to make. Such changes make even more important
24 accurate financial and structural information about the
25 various enterprises involved."

1 Would you comment on Mr. Knight's
2 conclusion?

3 THE WITNESS: Yes, first of all, my footnote
4 didn't quite agree with yours. So I am wondering --

5 COMMISSIONER BRENNAN: Are we on --

6 THE WITNESS: Whose copy I have -- but --

7 COMMISSIONER BRENNAN: You may have a different
8 printing.

Tape 10

9 THE WITNESS: Perhaps we should revise this.
10 Mine reads after the phrase "taken place between publishers
11 and record producers, as described in part 1 of the study,
12 see pages."

13 COMMISSIONER BRENNAN: Yes, I was just leaving
14 out the pages.

15 THE WITNESS: Seriously complicate the decision
16 that Congress is called upon to make accurate and
17 structural information about the various enterprises in-
18 volved, even more important. Is that -- does that show
19 on yours?

20 COMMISSIONER BRENNAN: Yes.

21 THE WITNESS: All right. Well, let's try to
22 sort this out. It seems to me he is making a couple of
23 points. First of all he is acknowledging the intervening
24 taking place between publishers and record producers, and
25 asking for -- asking the question whether or not that
complicates the situation.

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1 In my own view, I am not sure I agree with
2 the statement. It seems to me that whether the participants
3 are jointly owned as can happen in virtually any industry
4 of products where units are jointly held, it doesn't
5 necessarily imply to me the -- a relevance or irrelevance
6 or any increase or decrease in the relevance or irrelevance
7 of taking into account the financial conditions of the
8 parties.

9 We know full well there are many companies
10 who are still independent publishers or independent record
11 companies. Reading this as making the information about
12 the various enterprises more important, I don't see why
13 joint ownership should have any effect on the availability
14 of such information.

15 I guess the only reall issue is whether or
16 not the point becomes moot in that money would flow out
17 of one part of Warner into another or one part of CBS into
18 another, and I don't think that we are anywhere near that
19 condition. And I think the managers of those profits,
20 centers are undoubtedly operating under a considerable
21 independence, and it is -- it would be very necessary
22 it seems to me to know whether, for example, April
23 Blackwood is dependent on CBS for a fraction of its
24 income, just exactly what those transfers are.

25 So even through a publisher might be wholly
owned by a record company, or by a holding company which

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1 includes a record company, it doesn't strike me as necessarily
2 important to how they fell or how they would react to the
3 results that we're discussing here.

4 COMMISSIONER BRENNAN: You regard our need for this
5 data as a given, as a constant.

6 THE WITNESS: Absolutely.

7 COMMISSIONER BRENNAN: It is not altered by these
8 other circumstances.

9 THE WITNESS: Absolutely, I mean there is no
10 question that criteria of this kind have some economic
11 relationships imbedded within them that can be sorted out.
12 You are always going to be faced with some inputs of sub-
13 jective, nature and inputs of an objective nature, and it
14 is your role as an ad hoc study group to sort these things
15 out in the best way you see fit.

16 We can only provide information, give you our
17 opinions, and leave you the bite of sorting these things
18 out; I don't think we make your job any easier to say,
19 "Well, no, you aren't going to be able to use information
20 on such things as cost and risk and supply, et cetera."

21 COMMISSIONER BRENNAN: Our record has much
22 testimony concerning the role of the singer songwriter,
23 controlled publishers, and a shift in the distribution
24 of royalties as between the publisher and the composer
25 at the expense of the publishers.

1 THE WITNESS: But the --

2 COMMISSIONER BRENNAN: It might be argued
3 that because of these shifts, including a greater flow of
4 income, to the composer as distinguished from the publisher,
5 that evidence hereabout the financial condition of publishers
6 becomes economically irrelevant.

7 Would you address that argument?

8 THE WITNESS: I disagree. We don't have any
9 evidence. I don't have any evidence -- although we have
10 some evidence on the prevalence of singer-songwriters
11 who don't have hard evidence on how many of them have their
12 own publishing firms, first of all.

13 Secondly, although I did mention yesterday that
14 singer-songwriters are entering into publishing, and
15 arranging for the administrative tasks to be taken over by
16 others, I am not sure that means that one then says, "Now
17 the composer is earning 90 per cent, it is a 9/10
18 splitt" because the songer-songwriter does the creative
19 publishing function himself.

20 For herself. He works his own songs, works
21 his own material, can push the record companies with some
22 of his material, "Hey, how about trying some of this
23 stuff," he is a better marketer of his music than the
24 publisher, when he controls the whole flow.

25 So again, it is a matter of definition. As

1 they say, 90 per cent of the composing royalty, I don't
2 think that is accurate.

3 COMMISSIONER BRENNAN: I turn now to the 1975
4 House hearings, and the testimony of the concluding witness.
5 Miss Barbara Ringer, the then Register of Copyrights.

6 At page 1824, of the printed hearings, Miss
7 Ringer was wrestling with the pros and cons of creating a
8 copyright royalty tribunal. And testified as follows:

9 "With respect to the rather powerful role
10 assigned to the Tribunal, in connection with various
11 rate adjustments, we can see arguments on both sides.
12 We recognize that the Tribunal could be more effective
13 than Congressional committees in marshalling and evaluating
14 masses of economic data necessary for certain purposes."

15 What does that testimony suggest to you as
16 our mandate as you view it?

17 THE WITNESS: It would suggest to me that the
18 Register of Copyrights certainly envision that the
19 Copyright Royalty Tribunal would become an expert agency
20 in the sense of that word, which means thorough grounding,
21 understanding of the facts and issues pertaining to this
22 particular proceeding, and that that understanding would
23 be data based where relevant.

24 COMMISSIONER BRENNAN: Let's eliminate
25 any possible confusion as to Miss Ringer's view about

1 the mechanical royalty. We have rate jurisdiction in
2 several areas. At page 1876, of the House proceedings,
3 Miss Ringer testified as follows:

4 "Moreover, the bill in its present form,
5 creates a copyright royalty tribunal, which for the
6 future could undertake the kind of exhaustive study Mr.
7 Knight contemplated."

8 Does that leave any doubt in your mind as
9 to at least the view of the Copyright Office as to their
10 understanding of the mission being given to us in this
11 proceeding by the Congress?

12 THE WITNESS: No. No.

13 COMMISSIONER BRENNAN: The Australian Copyright
14 Tribunal in a recent proceeding, concluded that the financial
15 position of both the record producers and music publishers
16 are relevant to deciding the mechanical royalty rate.

17 What is your opinion about that conclusion?

18 THE WITNESS: I agree.

19 COMMISSIONER BRENNAN: Are you aware of any
20 economic reasons why that might be a valid conclusion
21 in Australia but not in the United States?

22 THE WITNESS: I have made no study of the
23 international situation as a part of my work.

24 COMMISSIONER BRENNAN: Are you acquainted or have
25 you read the Francis Report in the United Kingdom on

1 the mechanical royalties?

2 THE WITNESS: No, I haven't.

3 COMMISSIONER BRENNAN: We will pass that by for
4 the time being. We will come back to it later.

5 CHAIRMAN BURG: Commissioner, could you keep
6 your voice up, it is hard to hear you.

7 COMMISSIONER BRENNAN: You can never please
8 a female.

9 (Laughter.)

10 COMMISSIONER BRENNAN: Dr. Kiser, in your
11 research and your preparation for this appearance, have you
12 encountered any official report for any independent study
13 which has ever reached the conclusion that the respective
14 financial positions of the music publishers and record
15 producers are not relevant to a determination of the
16 mechanical royalty rate?

17 THE WITNESS: None that I recall.

18 COMMISSIONER BRENNAN: Two of my colleagues,
19 in different contexts, in this proceeding, have in essence
20 used the expression "we should not re-invent the wheel."
21 And it is possible that the Tribunal, when we draft our
22 conclusion in this proceeding, would structure our report
23 along the lines of the report of the Australian Copyright
24 Royalty Tribunal.

25 When Mr. Nathan testified, I read to him in the

1 chapter on the financial condition, financial evidende
2 of the music publishers, the various section headings.
3 And asked him to comment on whether or not we had in
4 our record information on these subjects. Were you present
5 for Mr. Nathan's testimony or have you read it?

6 THE WITNESS: Yes, I am not sure I recall all
7 those headings.

8 COMMISSIONER BRENNAN: Do you recall that Mr.
9 Nathan agreed with me that if we were to follow the format
10 of the Australian report, we would have a series of blank
11 pages?

12 THE WITNESS: I don't have any comment.

13 COMMISSIONER BRENNAN: Are you aware of any
14 data which was presented by the music publishers subsequent
15 to Mr. Nathan's testimony which would fill in any of these
16 blank pages?

17 THE WITNESS: No.

18 COMMISSIONER BRENNAN: It may be argued, it
19 has already been argued, that this issue of the economic
20 health of the publishers is a red herring in which the
21 record industry is trying to obfuscate these proceedings
22 and divert attention from the vigorous efforts of Mr.
23 Abram and Mr. Deutsch and Mr. Greenman to get additional
24 data from the record industry; and it has been suggested
25 that if the record industry was really sincere and serious

1 about this issue, rather than having an issue to take to the
2 Supreme Court, when we all get to that stage, that the
3 record industry and CRI would have sought to obtain
4 information about music publishers from public sources
5 and from the record and publishing integrated conglomerates.
6

7 Can you explain to me why you come in here
8 today and present no information, or practically no
9 information, concerning the financial condition of music
10 publishers?

11 THE WITNESS: Well, first of all, I think we have
12 pretty much exhausted public sources. I mentioned yesterday
13 they are pretty scanty. We developed many of our estimates
14 from trade press, and doing a lot of estimation in between
15 the lines in the gaps, I think they are reasonable figures,
16 but surely not a whole lot, with the exception of one
17 industry study that I have looked at, the Dranov study.

18 There is just not a whole lot out there now.
19 You are very perceptive. We try. The easy answer is we
20 tried. A number of companies told us "Well, speaking
21 for ourselves, our corporate interests, is clearly in
22 the area of the impact of the rate on the record company,
23 which is much bigger than the publishing company that we own,
24 I will try to find out."

25 In every place where we ask for such information,
which was not included in the questionnaire, because they

1 would never believe that it would be responded to but
2 we did ask in conversations and it was just quite clear that
3 the level of -- or the line of demarcation between these
4 profit centers was strong and the nature of the management
5 of the firms were let each party fight it out but we are
6 not going to get involved in an overriding corporate
7 change of management style on the autonomy and independence
8 of the two groups. It got nowhere.

9 I would have loved to come in here with in-
10 formation gleaned from the publishing divisions of our
11 companies, but we just simply couldn't get it.

12 COMMISSIONER BRENNAN: I want to turn now,
13 Doctor, to the pending modified motion of RIAA requesting
14 the production of certain financial data by the music
15 publishers.

16 Were you consulted by RIAA in the preparation
17 of this motion?

18 THE WITNESS: Yes.

19 COMMISSIONER BRENNAN: Then I would like to --

20 THE WITNESS: Is this the motion that you asked
21 for a simplification of?

22 COMMISSIONER BRENNAN: This is the modification
23 of that. I would like now to take you through this
24 modified motion item by item, and in each instance, address
25 yourself to what is the economic relevance to this proceeding

1 of the information being requested, and you may have
2 heard Mr. Abram this morning indicate some confusion or
3 misunderstanding as to the terminology and perhaps as we
4 go along you could clear that up.

5 Let's take the first item, Domestic Revenues
6 From Mechanical Royalties, and Other Recording Related
7 Sources Including Performance Royalties and Royalties
8 in Printing Income from Sheet Music and Songbooks.

9 Please explain to the Tribunal now what is
10 the economic relevance of that information to our mechanical
11 royalty determination?

12 THE WITNESS: Well, first of all, let me say
13 over the span of all of these items, I think a general
14 point needs to be made. And that is that the value of the
15 song is definable, estimable. It is an asset. These things
16 are bought and sold. As I mentioned yesterday in the
17 Screen Gems example. These copyrights are bought and sold.
18 These assets earned a return which is estimable, like any
19 other investment, and if that return is highly attractive,
20 or if it is not attractive, that is crucial information
21 for you to know.

22 The song is not -- most songs, I think, do
23 not earn money, only once, and from only one source, that
24 the copyright -- and the value of the copyright, it seems to
25 me is a crucial element for you to make some determination

1 about whether copyright owners are earning a fair return.

2 Now, we are not suggesting that the inclusion
3 of performance royalties should be thought of as a source
4 of income allowing the return from mechanicals to be low
5 or any other kind of cross subsidation between one source
6 of income and the other. All we are simply saying is
7 that these things are to a large extent produced and
8 rewarding because of the efforts of the recording company
9 that there has been other testimony here discussing the
10 relevance of the recording, the generation of performance
11 royalties, which is clearly obvious in the sense of radio
12 airplay. To some extent television.

13 There has been other testimony here that
14 has made the point I think very clearly that the sales
15 of sheet music and songbooks are to a large extent depen-
16 dent on identification with the artist which the recording
17 company invests in, which recording companies promotes,
18 and on an apples to apples basis, it seems to me that you
19 are being asked now, to consider the effects of inflation
20 on a single rate, and I don't see how you can do that
21 credibly without considering other sources of income as
22 well. So that is a long winded general comment that it
23 seems to me you are looking at an asset that has in financial
24 terms a net present value, and it seems to me that that
25 stream of income over a period of time, is what you are

1 really concerned, with, and the question is is that a
2 fair return on the creative work and on the investment of
3 the copyright owner.

4 That seems to me to be an analytical problem.
5 So here what we had in mind, was to look at domestic
6 revenues and what we mean by that is mechanical royalties
7 earned on recordings and paid by US record companies.

8 They would be analagous to the copyright mechani-
9 cal payments that are in our study, also to break out the
10 other two principal sources of income and we ignore the
11 synchronization rights, and those other two sources are
12 performance royalty income and printing income.

13 Now, here, you have a situation where publisher
14 might make a return on the licensing of sheet music,
15 and songbooks, and that is license income, the income from
16 the song, and that should surely be included. Whether
17 the publishing firm has a printing division, which makes
18 money as a printer, is relevant it seems to me only to the
19 extent that one also looks at recording company profits
20 from pressing, while pressing, or some other part.

21 Did you want to go on?

22 COMMISSIONER BRENNAN: Yes, let's go on now
23 to foreign revenues from the same sources.

24 THE WITNESS: Well, here again, there is just
25 no question that the growth of the recording industry

1 world wide, is far more rapid overseas than domestically,
2 and I made the point yesterday, that the health of
3 many of the record companies, which I have looked at,
4 is terribly dependent upon this source of revenue.
5 It is this same song. If the song is mastered in the
6 United States and licensed to be sold overseas, or pressed
7 overseas, it is the same song.

8 And the return to the copyright owner is not
9 only dependent upon what that recording, the same recording
10 -- what that recording earns in the United States,
11 but also what that recording earns overseas. And the same
12 with the record company. And that -- we have tried to
13 illustrate that, by drawing this distinction between
14 foreign mechanicals and domestic mechanicals and on
15 the recording company side, foreign license fees and
16 domestic license fees.

17 We weren't trying to be deceptive or misleading.
18 by not -- by producing an exhibit without foreign fees in it.
19 Of course not. It is very important. All we are illustrating
20 is that there is another part of that. Which is that if
21 those flow -- the profits of the recording industry, so
22 also do the mechanical royalties paid on the very same
23 recording, on the very same sales overseas on which those
24 foreign licenses are generated for the record companies.

25 So those flow in some proportion to the United

1 States. Now, I think the Tribunal could make use
2 clearly of some understanding of how important that stream
3 of revenue is.

4 It may be that the publishers are dependent on ,
5 foreign mechanicals, and the record companies are dependent
6 on foreign licensing fees, and then you can take that into
7 account.

8 COMMISSIONER JAMES: Your third group --

9 (End tape.)
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1 COMMISSIONER BRENNAN: Your third grouping, selling,
2 general and administrative expenses, composer payments, and
3 other operating expenses.

4 THE WITNESS: With regard to expenses, I don't know
5 how one can determine a fair return to owners without knowing
6 something about the structure of the expenses. With regard
7 to composer payments, it seems to me that the split is a very
8 important issue for you to make some determination about whether
9 or not your setting arrangement will flow primarily to copy-
10 right owners who are mainly music publishers or to composers
11 and what's happening with that trend. Right now, all you have
12 is anecdotal evidence of the testimony, I believe, of Mr.
13 Robinson on that split, and some anecdotal evidence on the
14 9010, which has been referred to in the trade press. I think
15 that's inadequate information to base a judgment upon.

16 COMMISSIONER BRENNAN: And the final grouping, pre-
17 tax profits from such recording-related sources.

18 THE WITNESS: Here again, it seems to me if you are
19 being asked to balance or to reflect the relative roles of the
20 owner and user in terms of risk, and to establish a fair return
21 to owners and fair income to users, I don't see how you can
22 make that judgment without this. As I mentioned yesterday,
23 in the financial community, return and income invite the same
24 numerators divided by a base. And whether you choose to look
25 at sales or assets or net worth is up to you. It seems to

1 me that without information of this kind you're hamstrung in
2 doing that. And I might just point out that this is a very
3 modest level of information, it seems to me, again, in terms
4 of aggregated information. It would also be awfully useful,
5 I would think, because again, you are looking at the value
6 of an asset that has a stream of earnings over time. It might
7 be useful to have some information on kind of a life expect-
8 tancy of a tune or the earning patterns of a sample of tunes
9 drawn from a catalog or a sample of catalogs. It might be
10 useful to have some kind of break-even information for tunes,
11 so you could draw some comparison with the relative risks of
12 the two parties. But this concept of a stream of payments
13 over time, I think, is so well known, and if you will permit
14 me just for one moment to add to that. I have here a little
15 clipping from the Washington Post. I don't have the date.
16 And it's referring to Paul McCartney --

17 COMMISSIONER BRENNAN: Even I recognize that name.

18 THE WITNESS: And the current activity that he is
19 engaged in in buying up songs. It says, Mr. McCartney has
20 bought the rights to 1,000 songs in a multimillion-dollar
21 transaction a couple of years ago. Those songs included
22 Georgia Tech's fight song, a number of other collegiate favo-
23 rites, such as "The Sweetheart of Sigma Chi", "On Wisconsin",
24 "One For My Baby and One More For the Road", Linda Ronstadt,
25 "You're No Good", "The Man That Got Away", Judy Garland made

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1 that popular, and "Stormy Weather", and there are some others
2 in here, "Sentimental Journey", "Autumn Leaves", "Bye-Bye,
3 Birdie", "Hello, Dolly". He goes on to say that -- and this
4 is, I assume, the author's discussion here, "Mr. McCartney
5 is worth between \$80,000,000 and \$120,000,000", and it says
6 that, "Years ago, after their initial success, Mr. McCartney
7 and Lennon sold the copyrights to their first 60 songs, and
8 rebought them, regained them. The royalties for those 60
9 songs topped 1.3 million pounds. That was his share, the
10 writer's share. And then it goes on to say, the wide range
11 in values of older songs make it almost impossible to price
12 them singly. As an example, the chestnut like "Stormy Weather",
13 even aside from a special circumstance like the mid-life hit
14 by Willie Nelson, which was discussed earlier in the article,
15 would be worth 10 to 15 thousand dollars a year to its publisher.
16 Because "Stormy Weather" has ten years of copyright life left
17 before entering public domain -- I didn't realize it was
18 written that long ago -- it would presumably be valued upward
19 of \$100,000. I don't agree with the arithmetic, necessarily,
20 but it's quite clear that even in newspapers, the journalists
21 have recognized that a song is an asset that can be bought and
22 sold, it can be traded, it can be valued in price, and they
23 can be analyzed from a financial point of view.

24 MR. SHERMAN: We would like to mark that as RIAA
25 Exhibit EE.

1 MR. ZUCKERMAN: I believe that's already in the
2 record.

3 MR. SHERMAN: I thought it was, but I'm told that
4 it isn't actually a cross examination exhibit on the list that
5 we gave you.

6 (Whereupon, RIAA Exhibit EE was marked for
7 identification.)

8 COMMISSIONER BRENNAN: Dr. Kiser, Mr. Zuckerman
9 told me last week, perhaps, in your absence, that the bottom
10 line on this is that even if I had made the request back in
11 April and putting aside your legal objections, your economic
12 objections, all your other objections, that it's just not
13 doable, you were involved in gathering the information from
14 the record industry. What is your assessment as to how much
15 of the information requested in the pending motion over a
16 four-year period would be readily available from a publisher
17 or available with relatively modest burdens.

18 THE WITNESS: Well, I have never had a chance to
19 study the cost accounting systems of publishers or anything
20 else. It seems to me those are simple financial accounts
21 that we are asking for, which should be readily available.
22 I have seen a few for some other companies back over time which
23 I did not base my testimony on. If I were a publisher, I
24 would imagine I would have data of that kind readily available.
25 I might not have data of the kind that I suggested would be

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1 useful readily available. That might be quite complicated.
2 It also seems to me that the publishing firms who are members
3 of the entertainment holding companies or the entertainment
4 conglomerates would readily have that information and that
5 would not be difficult at all to get. It then seems to me
6 it could become a problem of representativeness and how much
7 faith or trust you people want to put into the evidence that
8 that has presented to you. This dispute has been going on
9 for a long time. Mr. Nathan's comments back in 1965, I believe,
10 were to the effort by the recording companies to put forth
11 information that if we did that, they would come after our
12 representativeness just as much as we go after theirs. That's
13 not a quote but I could find something.

14 And that's fair, I suppose, and that's part of the
15 process that one goes through. But now that we have an expert
16 body to make a judgment, it seems to me that you have, in the
17 course of direct and cross examination, an opportunity to
18 judge how representative that is. You're never going to have
19 all the information from all the publishers or all the record
20 companies. But suppose the problem was one of gee, can you
21 tell me something about California. And I would answer yes,
22 I can tell you something about California. I will study
23 Los Angeles, I will study San Diego, I'll study San Francisco.
24 I am probably not going to catch Jenner or Mendoceno, but I
25 may be able to catch a sample of smaller towns where I can give

pw-11-6

1 you some indication of how things are a little different with
2 the smaller companies than they are -- or with the smaller
3 cities than they are with the very large ones.

4 Again, if the effort is approximate financial
5 condition, relative, I think, aggregate information put forth
6 to you in that spirit, is useful and would be relevant to
7 your proceeding.

8 COMMISSIONER BRENNAN: And we decide whether it's
9 a wash or how much weight to accord to it?

10 THE WITNESS: That's correct. And I would imagine
11 you would apply the same standard to this material.

12 COMMISSIONER BRENNAN: I said before in a half-hour we
13 will come back to the Francis report. Madam Chairman, I think
14 my watch is running a little slow, but in re-reading the
15 Francis report earlier this week, I was struck by the coin-
16 cidence of a particular date. I am reading from a Xerox
17 copy -- there will probably be the usual problems with the
18 correct page references. On my copy, it's Page 11, which is
19 the page with the summary of the financial data supplied by
20 the British record companies. Mr. Francis makes note in the
21 report that the entire report of the British record industry
22 was assembled during a period commencing on July 26th, 1976,
23 and concluding on October 8, 1976.

24 Dr. Kiser, do you recall the final concluding date
25 for this proceeding, as specified in the statute?

1 THE WITNESS: Our present proceeding?

2 COMMISSIONER BRENNAN: Our present proceeding.

3 THE WITNESS: You mean by the time you're to reach
4 a conclusion?

5 COMMISSIONER BRENNAN: Yes.

6 THE WITNESS: I believe it's --

7 COMMISSIONER BRENNAN: No. When does the pumpkin
8 come back to haunt us?

9 THE WITNESS: I believe it's the end of the year.

10 COMMISSIONER BRENNAN: December -- midnight,
11 December 31st. And by the way, you are welcome to come here
12 for a New Year's party, as we struggle to produce our final
13 decision.

14 THE WITNESS: Will you be partying or writing?

15 COMMISSIONER BRENNAN: Does not this suggest, Dr.
16 Kiser, that with a measure of good will that information can
17 be assembled in a relatively short period of time?

18 THE WITNESS: I think so.

19 COMMISSIONER BRENNAN: Mr. Fitzpatrick, about ten
20 days ago, stated that RIAA was filing a bare boned modified
21 motion allowing the music publishers to put some flesh on these
22 bones and to structure the request in the form that would best
23 facilitate their work and impose the least burden on them.

24 Mr. Abram, in your presence yesterday, at the
25 opening of the session, made what I must regard as the definitive

1 exposition of publisher's position on this issue. I will not
2 on this occasion discuss Mr. Abram's statement or in any way
3 characterize how responsive it was to my request.

4 Under the circumstances, however, Dr. Kiser, I
5 now find it necessary to request you to put some meat on this
6 skeleton, and I do not wish to further impose on the time of
7 my colleagues this afternoon. It will be adequate for my
8 purposes if you furnish a written response which can be incor-
9 porated in the record, describing in more precise detail the
10 information requested, and giving me your recommendation as to
11 the selection of the sample.

12 I want to turn now to some other subjects. I
13 asked Mr. Nathan and Dr. Rinfret to give their assessment
14 of the consumer price index. You recall that one of the
15 alternative options before us is to retain a flat rate with a
16 yearly cost of living adjustment related to the consumer price
17 index. Some economists and others have recently written and
18 spoken about deficiencies in the consumer price index. Both
19 Dr. Rinfret and Mr. Nathan gave the consumer price index using
20 all items and the cross-the-board consumer survey a very high
21 rating. What is your assessment of the consumer price index?

22 THE WITNESS: I guess I would give it a lower rating
23 for the following reasons. I was looking at the figures --
24 I can't remember the source, but they were a comparison with
25 the consumer price index over the last half a year or so, and

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1 GNP price deflator, which is a similar price index only
2 based on a more representative sample of goods and services
3 across the entire economy. And in only a six-month period
4 during which albeit, there were tremendous increases in interest
5 costs -- you recall from the first quarter of this year, the
6 CPI was four or five percentage points higher year-to-year
7 than the GNP price deflator. So, clearly, we're seeing the
8 role of interest costs in the CPI, in that simple comparison.
9 By the same token, now that interest rates are declining,
10 I suspect the CPI will decline faster. I have here a little
11 article from the "Wall Street Journal" of Monday, July 7th,
12 a chap by the name of William G. Flannagan, a staff reporter
13 of the "Wall Street Journal", says, "Despite the widespread
14 acceptance of the CPI, experts are quick to point out that it
15 has at least two major flaws. It doesn't include personal
16 income taxes and it is much too heavily weighted for housing
17 costs. Few people buy houses the month that figures are
18 compiled, of course, yet according to recent CPI figures,
19 people are spending 44 percent of their incomes on shelter.
20 It is obviously much more than most of us actually pay. Yet,
21 the CPI endures, and in fact, prevails. This is so for mainly
22 two reasons: Labor loves it as a gauge for cost of living
23 increases, because it is generally higher than other inflation
24 benchmarks. The government loves it because directly or
25 indirectly, it bumps wage earners into ever higher tax brackets."

1 It goes on to say that, in this article, actuaries at the
2 Big 8 accounting firm of Touch-Ross attempted to put together
3 an index of actual changes in prices which resulted to another
4 measure of inflation that was much closer to reality than the
5 CPI. For one thing, it counted income taxes, and for another,
6 it was based on actual expenditures for consumables and other
7 items, and not what the prices of those items might be. And
8 what that issue is is that people adjust to inflation, we all
9 have. And if the price of a certain good or service rises,
10 we tend to substitute, we buy less of it or we buy more of
11 something else. Most of us adjust to inflation in a way which
12 minimizes the impact upon us. It is still a heavy impact,
13 we still suffer from inflation. But the CPI is not necessarily
14 a measure of the impact of inflation on the individuals actually,
15 in terms of what they actually bought.

16 COMMISSIONER BRENNAN: I want to again borrow
17 Commissioner James' hypothetical, and as usual, Commissioner,
18 make some alterations.

19 THE WITNESS: I would like to add a footnote at
20 some point.

21 COMMISSIONER BRENNAN: Please go ahead.

22 THE WITNESS: Okay. I did make clear in my comments
23 of May 5th, that it seems to me that the use of the COLA has
24 some very serious disadvantages. And I think --

25 COMMISSIONER BRENNAN: What?

THE WITNESS: COLA. I'm sorry. Cost of living

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1 allowance or a CPI-related inflating factor. And I believe
2 I recall Mr. Nathan saying he wasn't recommending that proposal
3 over the percentage rate.

4 First of all, it puts the price on an input that is
5 unrelated to relative contribution. And if other forces drive
6 prices faster, the input that is priced in a way that the five-
7 cent COLA proposal would price the song can actually go up
8 much faster than inflation. And the reason for that is
9 because of volume. And I don't know of any other circumstance
10 in economics or an input price that's guaranteed protection
11 against inflation and given the full benefit of an increase
12 in volume. This would be remarkable. It has a compounding
13 effect, as well. That may or may not bear any resemblance
14 to the health of the recording industry or to the prices of
15 the recording industry. It doesn't strike me terribly meaning-
16 ful to have the recording industry less protected from infla-
17 tion than its input price.

18 MR. ABRAM: Madam Chairman, may I inquire if the
19 witness is reading from something.

20 THE WITNESS: I'm reading my own notes.

21 MR. ABRAM: Are you reading from something?

22 THE WITNESS: I made some notes on certain issues.

23 MR. ABRAM: I think, Madam Chairman, I am entitled
24 to see what he is using in connection with a response he just
25 gave.

1 MR. FITZPATRICK: May I suggest that we have plowed
2 this ground two or three times. You had earlier objected in
3 one circumstance where you thought the witness was talking to the
4 Tribunal. You were concerned about typewritten materials. At
5 the time, you or Mr. Zuckerman said that your witnesses, your
6 experts came in with notes and you had absolutely no concern
7 with notes.

8 MR. ZUCKERMAN: I beg your pardon, Mr. Fitzpatrick.
9 What I said was that our witnesses had source materials, such
10 as copies of the economic studies.

11 MR. FITZPATRICK: I must say that I think in prepara-
12 tion of a whole series of questions, I presume Dr. Kiser has
13 made his own notes about a number of points that could come
14 up. I think he's answering the Tribunal. I don't see any use
15 that's served by Mr. Abram going over his notes. And I object.

16 MR. ABRAM: Madam Chairman, may I be heard, please?

17 MR. ABRAM: At the outset of this hearing, I asked, and
18 Commissioner James responded, and no one disputed his response,
19 the rules of evidence did govern.

20 COMMISSIONER BRENNAN: Absolutely not. I am sure
21 Commissioner James does not and did not so represent.

22 COMMISSIONER JAMES: Again, the record will speak
23 for itself.

24 MR. ABRAM: Well, I think -- I don't want to get
25 into any kind of hassle, but I think when a man is obviously

1 and the Tribunal can see, is reading in response to his
2 question about inflation from -- reading papers, about four
3 in number. I think we are entitled to test his credibility
4 by seeing what he is reading from. I have no doubt that when
5 our witnesses are on the stand, if anyone wished to see what
6 they were using to refresh their recollection in testimony
7 given under oath, anyone would be entitled to it. But I am
8 in a position where I cannot cross examine a witness and test
9 him in a normal way when he is using notes which are being
10 turned into words, and I am not permitted to see them. I
11 can't understand the reluctance, frankly.

12 COMMISSIONER BRENNAN: As far as I am concerned,
13 Dr. Kiser, I think we have exhausted the issue of inflation.
14 I will put Commissioner James' hypothetical back on the shelf
15 and conclude this unfortunately long colloquy by asking you
16 one question I know everybody is waiting for me to ask, which
17 is: In your opinion, when is it justified for the federal
18 government to interfere in the regulation of private business
19 relationships?

20 THE WITNESS: In my opinion, only when, by legis-
21 lative sessions, the government has concluded that the
22 public service would be better served through regulation,
23 through rate setting, through watch-dog agencies, through
24 monitoring of various kinds, and would otherwise occur in the
25 functioning of the free market.

COMMISSIONER BRENNAN: Do you find the existence of

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1 these factors present with the mechanical royalty?

2 THE WITNESS: That was the decision of Congress in
3 1976.

4 COMMISSIONER BRENNAN: My question was, what is your
5 view?

6 THE WITNESS: Are you asking me my view on the compul-
7 sory license?

8 COMMISSIONER BRENNAN: Yes.

9 THE WITNESS: I will be happy to share that with
10 you. There's no question that the occasion or the conditions
11 which prompted the compulsory license in the first place
12 are now gone. There is very little reason in my opinion to
13 believe that anything like the market condition of the alien
14 company would occur again. If this were the 1950's, and the
15 markets were less concentrated, both on the record producing
16 side and on the music publishing side, than they are today,
17 I might be inclined to junk it, and get rid of it. I'm nervous
18 about doing so in the present day.

19 Let me add that I think the natural anatomy of the
20 economist is that the license clearly creates some cross
21 subsidies from one song to another. One would assume some
22 would go to higher rates; therefore, those that are being paid
23 at a flat rate, but should otherwise have a lower rate, be
24 earning less, and shouldn't those who would otherwise be
25 paid at a higher rate, earn more. So, the cross subsidy issue

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1 is one that is uncomfortable. It is not the only price in our
2 society that is established with cross subsidies in mind. For
3 years, long distance phone calls have subsidized local phone
4 calls. It's an issue that's rather hot in this town right
5 now, and whether or not that's going to go by the boards, one
6 waits and sees.

7 But for the present, I'm nervous about getting rid
8 of the compulsory licenses, if we had the choice, and it's
9 primarily because of the dominance of the singer-songwriter.
10 I think this is a new force in the marketplace. It seems to
11 me that if the license were removed and any rates rose, I don't
12 know whether the median rate would fall or not. But if any
13 rates rose, they would be the rates that accrued to the out-
14 standing singer-songwriters and non-singer-songwriters. And
15 one has to ask, what would happen. The chain of logic is that
16 took place, and it seems to me that some of the effect of
17 that may not be in the interest of the criteria. They
18 include prices of certain popular recordings, no doubt rising,
19 the volume falling, which would be detrimental to the other
20 kinds of recordings. It may include prices falling of catalog
21 and less popular recordings which might be a benefit to the
22 consumer. But, primarily, I am frankly worried about the power
23 of the singer-songwriter to extract, as would be his due under
24 such a system, an enormous share of the consumer income going
25 to recordings, to the detriment of availability and to the

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1 detriment of variety, and it seems to me that that's another
2 issue, the maximization of dissemination that was clearly in
3 the thoughts of those who initiated the compulsory license in
4 the first place, and I think clear in these criteria.

5 In short, I think you get exclusivity. I think you
6 get it in spades, and you get all kinds of varieties of it.
7 You get singer-songwriters forming their own record labels,
8 you get record companies buying out songs, you probably see
9 the best songwriters going on to a contract basis, and they
10 will be paid high rates, And I don't know whether that kind
11 of concentration of artistic endeavor is in the best interest
12 of the society.

13 The one thing that fixed rate does is permit an
14 awful lot of tunes, all the tunes, really, to go at the same
15 price, which contributes to the availability of music at an
16 affordable price. That's what you're really having to weigh,
17 balance between that and the return of the copyright owners
18 which you are having to weigh.

19 CHAIRMAN BURG: Thank you very much, Doctor, for
20 your patience.

21 Recess.
22
23
24
25

1 MR. ABRAM: Madam Chairman, at a point a few
2 minutes before adjournment, I had moved that we be permitted
3 to inspect the notes from which Mr. Kiser -- Dr. Kiser
4 was either reading or refreshing his recollection. They
5 seemed to be on green sheets of paper, and roughly, I would
6 calculate them to be four or five sheets.

7 There was no ruling on the motion, and I'm not
8 pressing that at this moment, though I did ask that we be
9 permitted to see them at the time, and there just was no
10 ruling.

11 I would now like, Madam Chairman, in the interests
12 of time, and also with respect to the motion, that I made,
13 and which still is pending, to have those notes marked by the
14 court reporter and placed in the hands of the Tribunal for
15 safekeeping, as a part of the record in this case, pending
16 some final disposition of the motion.

17 MR. FITZPATRICK: Madam Chairman, may I make one
18 very brief comment? I would like what I believe is a defi-
19 nitive word here, and I'm referring to Mr. Cornyn's testimony
20 on page 19, in which a similar question came up about Mr.
21 Cornyn, and let me just read a couple of paragraphs, if I
22 might, very briefly.

23 "Madam Chairman, we're here trying to describe an
24 entire industry, the way an industry operates, and we've
25 been doing it in a very lengthy process and making sure that

1 Mr. Cornyn covers all of the points that we would like to
2 have covered in his direct examination."

3 MR. GREENMAN: What is the date on that?

4 MR. FITZPATRICK: That's the date that he -- the
5 first of July. "We're trying to describe an entire industry
6 here, the way an industry operates, and we can do so in a
7 very lengthy process by making sure that Mr. Cornyn covers
8 all of the points that we would like to have covered in his
9 direct examination, by asking all of the questions, and we
10 will get out all the answers.

11 "We're simply trying to expedite this procedure
12 by giving Mr. Cornyn's own checklist of points that he would
13 want to make in response to these questions. He's under
14 oath, the testimony is his -- I don't think there's any
15 question about that.

16 "If the Tribunal feels it is inappropriate to
17 try and expedite this procedure in this way, then we won't
18 refer to notes at all. It seems to me that, in the
19 interests of everybody's time, we will all be advantaged
20 by his glancing at notes from time to time, to keep the
21 testimony moving."

22 The Chairman responded, "In all due respect, I did
23 not notice he was reading from a script, Mr. Zuckerman. If
24 he does glance at notes on occasion, I find with other
25 witnesses that that is also perfectly acceptable. Please

1 continue."

2 I must say, I think that the idea of some kind of
3 melodramatic marking of notes for safekeeping is something
4 of an insult to a witness who is under oath, who has indeed
5 prepared his thoughts for a number of matters that most
6 surely are going to come before the Tribunal.

7 Now, I think that this is a bit much, to somehow
8 invest notes of one's own knowledge of the industry, with
9 some kind of gloss of impropriety. That simply isn't the case
10 here, and I would quite vigorously object to the proposal
11 that they be so marked.

12 CHAIRMAN BURG: We are going to have to recess.
13 Please, all of you, stay in this room while we depart.

14 (A short recess was taken.)

15 CHAIRMAN BURG: On the record.

16 Dr. Kiser, do you have any valid reasons for not
17 showing Mr. Abram your notes?

18 THE WITNESS: My notes are simply organized on
19 the issues that I expected to be cross-examined on, and
20 the points that I wanted to make. They are completely my own
21 doing. I imagine that I have notes here on issues which I
22 anticipate Mr. Abram will ask of me. Those, I would just
23 as soon not disclose to him at this time. I have no problem
24 whatsoever with reading the notes on the topics that I was
25 just referring to.

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1 CHAIRMAN BURG: With reading the notes, or showing
2 Mr. Abram the notes on the subjects that are in question?

3 MR. ABRAM: That's all I wanted, Madam Chairman,
4 were the notes that he had in his hand. About five pages --
5 seemed to be green paper, to which he was referring, about
6 the question that was then being put to him.

7 CHAIRMAN BURG: And the question, as I recall it,
8 was the CPI? I ask the question again -- do you have any
9 objections?

10 THE WITNESS: To him seeing the section on COLA?
11 No, none whatsoever. I don't know if you can read my writing.
12 I'll read it to you. "COLA -- one, unrelated to relevant
13 contributions" --

14 MR. ABRAM: All I asked, at this point, was that they
15 be preserved, marked and preserved, and then we can get to
16 that later, if you wish to do that.

17 COMMISSIONER JAMES: I thought your original
18 question was, you would like to see them.

19 MR. ABRAM: I would have liked to have seen them
20 before I examine him, but I just wanted them preserved,
21 and before I examine him, I would like to see the --

22 COMMISSIONER BRENNAN: Dr. Kiser, as I understand,
23 has agreed, on the current point, to make the notes available
24 to you.

25 MR. ABRAM: Oh, that's fine. If he would make

1 them available, that would be fine.

2 COMMISSIONER BRENNAN: On inflation.

3 THE WITNESS: On COLA?

4 MR. ABRAM: Whatever pages he was reading from.

5 THE WITNESS: No, the section on COLA covers about
6 three square inches.

7 MR. ABRAM: No, he was referring to -- maybe he
8 could tell us better. You know, I can, perhaps, try to des-
9 cribe it. There wre notes, Dr. Kiser -- a green paper --

10 THE WITNESS: I'm color-blind. I don't know.

11 CHAIRMAN BURG: It looks green.

12 MR. ABRAM: And I was trying to -- I think there
13 are three pages, is that what it is? Two and a half hand-
14 written pages?

15 CHAIRMAN BURG: But do those cover the question at
16 issue?

17 THE WITNESS: Only one tiny fraction of one page
18 covers COLA.

19 MR. FITZPATRICK: I believe Dr. Kiser said he
20 would be happy to read those for Mr. Abram's benefit.

21 CHAIRMAN BURG: And I think he also said he would
22 be happy to show that portion to Mr. Abram.

23 MR. FITZPATRICK: We'll do it either way.

24 MR. ABRAM: Just one other question -- I want to get
25 it overwith quickly. Did Dr. Kiser -- and I'll just take

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1 his report, because I don't really want to belabor this --
2 did you refer to those other notes during the course of your
3 testimony?

4 THE WITNESS: On COLA? No, sir.

5 MR. ABRAM: The other notes on the two and a half
6 pages?

7 THE WITNESS: When?

8 MR. ABRAM: Today.

9 THE WITNESS: I don't believe so. I may have -- I'm
10 not sure.

11 MR. ABRAM: Well, look at them to refresh your
12 recollection.

13 COMMISSIONER BRENNAN: Madam Chairman, the only
14 pending issue is Mr. Abram's request to --

15 CHAIRMAN BURG: I understand that. I would like
16 that resolved before we --

17 COMMISSIONER BRENNAN: I don't think this is the
18 proper time to rehash the entire day's proceedings.

19 MR. FITZPATRICK: Madam Chairman, we're happy to
20 preserve the documents -- preserve the notes.

21 MR. ABRAM: That's exactly what I wish, and I
22 would like to see the COLA notes, if I may. That would be
fine.

23 CHAIRMAN BURG: Is that agreeable to all concerned?

24 MR. FITZPATRICK: Yes.
25

1 CHAIRMAN BURG: Dr. Kiser?

2 THE WITNESS: When?

3 CHAIRMAN BURG: I trust you will work that out.

4 MR. FITZPATRICK: I want it clear that what we
5 have suggested is that the notes -- Commissioner Brennan has
6 asked some questions about COLA, and Dr. Kiser had some
7 thoughts about COLA, and has referred to his notes about COLA,
8 and we have now offered, at the conclusion of that dialogue,
9 to give you the information.

10 MR. ABRAM: Give me the notes on COLA, and pre-
11 serve the rest of it.

12 MR. FITZPATRICK: Preserve the rest of it?

13 MR. ABRAM: That's exactly right.

14 MR. FITZPATRICK: That's fine.

15 CHAIRMAN BURG: The Chair's understanding is that we
16 will continue. Dr. Kiser, as I recall, 14 record companies
17 responded to your questionnaire. Is that correct?

18 THE WITNESS: We had two unusable responses, so 16.

19 CHAIRMAN BURG: But 14 were --

20 THE WITNESS: But 14 respondents that we made use
21 of, yes.

22 CHAIRMAN BURG: -- incorporated in your study?
23 If I'm correct, and if I recall other testimony, previous
24 testimony -- well, let me ask, am I correct? Are there 66
25 recording companies in this country?

1 THE WITNESS: No, I think there are probably closer
2 to 1,000 or 800.

3 CHAIRMAN BURG: Well, 66 that are RIAA? Where do
4 they --

5 MR. SHERMAN: Actually, 55 members of RIAA.

6 MR. ZUCKERMAN: Madam Chairman, I believe the 66
7 figure was the figure that was given in Dr. Kiser's report.

8 THE WITNESS: Right. I may point out that when I
9 wrote the report, I wrote it as all 66 RIAA member companies.
10 That was inaccurate. There were 12 prospective members
11 that the questionnaire went to as well, so --

12 CHAIRMAN BURG: I guess that really is not relevant
13 to the question I'm going to ask. So, 14 responded?

14 THE WITNESS: Yes.

15 CHAIRMAN BURG: Do you consider that a fair sample?
16 Is that a sample that is reliable in this type of instance,
17 this type of study?

18 THE WITNESS: There are a number of issues around
19 that, and as I indicated yesterday, we think that. among
20 the 14, we caught in our net a pretty good representation --

21 CHAIRMAN BURG: Some large, some small?

22 THE WITNESS: Some large, some small. We have
23 pressers, we've got it pretty good integrated in terms of
24 their own distribution networks, and others who sold through
25 independent distributors. And in terms of the patterns of

bd-13-9

1 competition in the industry, we have a fairly good repre-
2 sentation of the different types of competition. It's not
3 as large a sample as I would have liked. I would have loved
4 to have had 30 or 40, some more numbers, for the following
5 reasons. It would have allowed me to make a stratification
6 of the sample, and to do an analysis of how the small firms
7 did, how the medium-sized firms did, and how the very large
8 firms did, which I think would have added to both the quality
9 of understanding that you can gain from what I've presented
10 to you, as well as statistical reliability in a more techni-
11 cal sense.

12 CHAIRMAN BURG: Well, of those 14 -- or with those
13 14 respondents, then you, in effect, weighed or extrapolated
14 -- for instance, when you got the figure, and I want you to
15 go through this for me again, so that I do understand it --
16 for the net sales, in terms of how those 14 companies reflec-
17 ted the net sales of the entire recording industry in the
18 United States, and I think that that was Appendix B.

19 Would you go through those steps, not in great
20 detail, but just briefly for me?

21 THE WITNESS: Yes. The only reason we extrapolated
22 to the industry as a whole was to get a -- to draw a bead
23 on two numbers, the aggregate sum of copyright mechanical
24 royalties, from a representative total, and profits, primarily.
25 We didn't really ever spend any time on aggregate artists'

bd-13-10

1 royalties, or aggregate sales and promotion expense, although
2 Mr. Nathan did base some of his testimony on those figures.

3 Now, if we have 50 percent of the industry, you
4 have a choice, if you want to develop an aggregate -- 50 or
5 60 or 70, depending on what you have. You can aggregate by
6 parts, or you could aggregate by the whole. And what I mean
7 by that is, we can take all of the sample companies together
8 and say, we have 50 percent -- if we just aggregated to
9 the whole, and said that what we have in this sample is
10 representative, if we were asked, we would simply double
11 what we have, by dividing by .5.

12 You could also, in the spirit of which I was
13 just discussing sample design, you could have made some strati-
14 fications of the respondents, and you could have said, okay,
15 we'll take all the small companies in a different basis --
16 we could take the large companies and blow them up in a
17 different basis, because we might assume we have more of the
18 large than -- as among the non-respondents -- in other
19 words, there are a number of ways to approach the problem.

20 We did it the way we did it for two reasons.
21 One, it's simpler -- a simple concept. We just are saying,
22 okay, for the purposes that we are using these data, which
23 is to draw a bead on total mechanicals and total profits,
24 we believe that treating the sample as representative of
25 the non-respondents, who did not respond, is adequate.

bd-13-11

1 In addition, we did not want to err on the side
2 of favoring the position that we thought the data led us
3 to, and as I testified yesterday, my experience in most
4 industries is that the larger firms tend to be more profit-
5 able, relatively, per dollar of sales, to the smaller firms.

6 By extrapolating from the sample that we had,
7 which over-represents large firms and under-represents small
8 firms, we are, if anything, in my opinion, overstating
9 the profits of the industry.

10 And it seemed to me that that was a conservative
11 approach that was, in this instance, quite appropriate.

12 CHAIRMAN BURG: Doctor, is that a usual practice,
13 doing it the way you did -- an accepted practice?

14 THE WITNESS: I certainly believe so. I think
15 most people do it with less precision than we did it,
16 simply by saying, well, gee, there are about 30 in the indus-
17 try, so I'll make the industry's triple -- and it's the
18 same kind of concept. But what we did do is, we made every
19 effort to try to measure the relationship between wholesale
20 and list, and make sure that we had, indeed, a fraction
21 that was based on the estimated net sales of the industry
22 that was defensible.

23 CHAIRMAN BURG: So you essentially got two types
24 of data, the net sales and the combined mechanical royalties?

25 THE WITNESS: Well, we got all of the financial

1 statistics supplied to us by the respondents. But in deter-
2 mining how one would then estimate --

3 CHAIRMAN BURG: That's what I'm talking about, in
4 terms of the total industry figures.

5 THE WITNESS: -- for the industry total, we then
6 took the percentage of net sales represented by our respon-
7 dents, and said, all right, what percent of the industry is
8 this, because we didn't know. All right, RIAA reports an
9 estimate of the size of the industry, defined in terms of
10 list price, so then we said to ourselves, well, okay, if
11 we knew the relationship between list and wholesale, we would
12 then have a benchmark of total net sales for the industry
13 at wholesale.

14 And that's what we did, with an elaborate process
15 of weighted averages from all our wholesale price data,
16 and that came out to be about 50 percent, between wholesale
17 and list. The old rule of thumb held out -- it was quite
18 true.

19 So then, whatever RIAA reported as the industry's
20 sales, say, \$4 billion, we would then say, okay, valued at
21 wholesale, that's \$2 billion -- and then what is the aggre-
22 gate sum of the net sales of our respondents divided by that?
23 And that gave us the percentage of the sample.

24 CHAIRMAN BURG: Did you do anything that would
25 give you a share of the total domestic recording sales of

1 these 14 respondents -- their share of the total?

2 THE WITNESS: Yes, that is the sample size, if
3 you will, that is reflected by -- let me turn to the new
4 Exhibit 1.

5 CHAIRMAN BURG: New Exhibit 1?

6 THE WITNESS: Yes. That is reflected by the line
7 that's -- it's not numbered, but it's two-thirds of the way
8 down the page, where it says, "estimated percent of industry
9 represented by sample." And so you see that, in the three
10 years that we did this survey for, it varied from about
11 60 percent to slightly over 70.

12 CHAIRMAN BURG: In your study on the break-even
13 point, you had the 140,500 -- that was given in units.

14 THE WITNESS: Yes.

15 CHAIRMAN BURG: Let me ask you again, just for
16 the record, so I can keep this all in one place -- what
17 costs did you include in that break-even point?

18 THE WITNESS: Each of the companies was asked to
19 compute their break-even for us, and then we dealt with
20 the combining of the statistics that they provided. The
21 costs that we suggested that they include are given in Sec-
22 tion F of the questionnaire, and they included, among the
23 variable costs, artists' royalties, fund payments, mechani-
24 cal royalties, variable manufacturing and shipping, variable
25 A & R and studio expense, variable SG & A.

bd-14-1

1 That's a pretty comprehensive list. As it turned
2 out, none of the companies reported any variable A & R and
3 studio expense, because that's in the unfixed costs of
4 recording. Then, in the fixed costs --

5 CHAIRMAN BURG: All right. That really leads me
6 to my next question. Were all respondents consistent in
7 answering the questions with the breakdown you've given? In
8 that breakdown, did they all use the same --

9 THE WITNESS: Predominantly so. One company
10 did not report any fixed A & R studio and talent costs, and
11 I don't know why, unless that was included in their unrecouped
12 artist royalty costs, which was another element of fixed
13 costs.

14 But, other than that, all the companies had a
15 response for all of the items, except the one that I indica-
16 ted to you, where none of them had a response.

17 CHAIRMAN BURG: All right. I'm going to make an
18 analogy to the movie companies, when they produce a film,
19 and generally, I guess, as I recall, the measurement is,
20 or the rule of thumb is, that you have to double the pro-
21 duction costs to arrive at your break-even point for that
22 motion picture -- that used to be, anyway, the negative
23 cost. But in there, and there's been a lot of criticism
24 about that, is that it's a dumping ground for all kinds of
25 other costs which should not be in there.

bd-14-2

1 Do you see any of those classifications in this
2 survey, where some dumping could go on, that would be undetec-
3 ted?

4 THE WITNESS: Well, I don't know offhand what you
5 mean by dumping. It seems to me --

6 CHAIRMAN BURG: Well, costs that would not fulfill,
7 in the technical sense, the definition of those criteria.

8 THE WITNESS: We asked the -- I would guess, then,
9 that you're referring to fixed costs. Certainly, fixed A & R
10 and studio should be in there. It would be common to the
11 negative costs of a film. Unrecouped artists' royalties
12 and bonuses, it seems to me, would be in there, quite appro-
13 priately, because those are the sunk costs of the firm
14 which have to be recouped at some point.

15 And there's been previous testimony about trying
16 to earn back the unrecouped royalties and unrecouped record-
17 ing costs which you have already spent on an artist, because
18 you're looking at him, not just album by album, but over --
19 cumulatively, so to that extent there may be unrecouped
20 recording costs from a previous album that did not break
21 even, loaded into the analysis of this one, that it seems
22 to me that's appropriate, because those are real dollar out-
23 flows that have to be recouped.

24 Then fixed manufacturing and shipping -- we did
25 not go at length to the companies to find out how they did

bd-14-3

1 this. I would assume that they took their manufacturing
2 and shipping that was related to the production of records,
3 and allocated it across releases on an average basis. Also,
4 depreciation and SG & A -- so it's a comprehensive study,
5 and it certainly would include corporate overhead -- most
6 of the corporate overhead that they have to cover.

7 CHAIRMAN BURG: So you could bury costs that
8 weren't necessarily applicable to --

9 THE WITNESS: I think it depends on what your
10 purpose is, and what you mean by breaking even. If we had
11 asked them to give us a break-even analysis where you covered
12 the costs of the recording, and not any other costs, it
13 would definitely have been a different analysis, and they
14 would have broken even at a lower point.

15 But from a business perspective, I don't -- if you
16 were analyzing the recording expense, per se, that might be
17 useful. But our purpose was, you know, you're a business
18 enterprise, you've got to cover your costs -- these are
19 all real dollar outflows, and I guess I'd simply -- I
20 understand what you're driving at, but in the sense of dump-
21 ing other costs in -- who's going to pay for those costs if
22 the releases don't, so --

23 CHAIRMAN BURG: Your study said that, in 1963,
24 the break-even point was 7,800 units, and that jumped up
25 to 61,000 in 1972, and then virtually more than doubled from

bd-14-4

1 that point on.

2 Two questions -- what do you think attributed
3 that dramatic increase from 1963 to 1972, and then, what in
4 your estimation contributed the increase that doubled it
5 from that point on?

6 THE WITNESS: I don't have any reason to think that
7 the reasons between the two periods were all that different.
8 It seems to me primarily three things. First of all, as I
9 made clear on the chart that I introduced this morning,
10 starting from about 1963 forward, the record prices have not
11 kept up with inflation.

12 And what that means is that the variable costs
13 pushing on a record are rising, let's say, with inflation,
14 or perhaps faster than inflation, but the price isn't, so
15 that you're getting a squeeze on the margin that you're mak-
16 ing on those albums.

17 In addition, there has been ample testimony on the
18 increase in recording costs, which is on the fixed cost
19 side, and that just means you start with a more -- you start
20 deeper in the hole than you would otherwise have. So, even
21 if the contribution per album doesn't change, it takes more
22 albums to break even.

23 And finally, the increase in selling and promo-
24 tion expense which the companies have engaged in, to increase
25 volume, would also be a contributor. But I've done no

bd-14-5

1 disciplined study of just exactly why those points changed.

2 And I want to point out that this is an average,
3 and there's a lot of variation around the average, as the
4 testimony has shown. We think the trend is more useful than
5 the number, and the trend is up.

6 CHAIRMAN BURG: In preface to your study, you said
7 that you had done many reports for various industries --
8 banking, retailing, the computer industry, one thing or ano-
9 ther. Has there ever been a comparable situation, Doctor,
10 where you did an economic study for an industry that in turn
11 appeared before a governmental ratemaking proceeding, and
12 invoked confidentiality, and released those figures only in
13 the aggregate?

14 THE WITNESS: No. Almost all of the other work
15 that I have done has been of a proprietary, single-client
16 nature.

17 CHAIRMAN BURG: Thank you.

18 COMMISSIONER COULTER: Dr. Kiser, you've indicated
19 that you've expressed concern about the publishers' profits,
20 if I am correct?

21 THE WITNESS: Yes.

22 COMMISSIONER COULTER: Does that --

23 THE WITNESS: I've expressed concern about the
24 recording companies' profits, too.

25 COMMISSIONER COULTER: Well, okay, but in your

bd-14-6

1 interest in publishers' profits, is there, in that interest,
2 a feeling that they make too much?

3 THE WITNESS: I would hope that music publishers
4 succeed, and do well, and I hope all songwriters become
5 as affluent as the one that was depicted by Dudley Moore in
6 the movie, "10."

7 The only issue I have about profitability is rela-
8 tive, and it seems to me that that is what is called for, a
9 relative comparison of profitability, in terms of the cri-
10 terion.

11 In addition, I do allude to the fairly common situa-
12 tion that occurs in rate-setting proceedings, where some
13 showing of an inadequate return is commonly considered as
14 part of the justification for a rate increase.

15 COMMISSIONER COULTER: Well, am I to gather from
16 that that you don't think they make too much?

17 THE WITNESS: Well, too much relative to what?
18 Relative to recording companies, I find that it makes little
19 economic sense that a party that is not taking the risks,
20 earns what appears to be a greater return than the party
21 that is taking the risks. In that sense, sure. If the
22 recording companies were earning 25 percent on sales and so
23 were the publishers, I don't think I would be particularly
24 concerned.

25 I have no social -- I attach, certainly, no social
stigma to high profits.

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1 COMMISSIONER COULTER: You don't?

2 THE WITNESS: Albeit --

3 COMMISSIONER COULTER: You rejected the use of
4 the Rinfret survey as a way of getting at the publishers'
5 profits. Do you think the publishers made too much, vis a vis
6 composers?

7 THE WITNESS: I would like to see more information
8 on that. It seems to me that, to the extent that the kind
9 of testimony that I read into the record yesterday by the
10 chap from Arista Music Publishing Group, is indicative, and
11 to the extent that the composers don't know what their
12 splits are, or how much they're making, which the Rinfret
13 study also showed, I think it's a very important issue, in
14 terms of insuring the adequate income of songwriters.

15 COMMISSIONER COULTER: So that you are worried
16 that composers may not be making enough, vis a vis publishers?

17 THE WITNESS: Yes, I think the split's a very
18 important issue, and one wonders how knowledgeable the
19 songwriters are of that split, given the Rinfret data, and
20 one wonders how representative the Chappell number of 61-39,
21 or whatever, is of the rest of the industry, and one wonders
22 what the trend is.

23 COMMISSIONER COULTER: Does your interest also
24 exist with the phenomenon of the singer/songwriter?

25 THE WITNESS: Sure.

1 COMMISSIONER COULTER: It does? Well, you do
2 know, though, that the singer/songwriter is a new -- rela-
3 tively new phenomenon of this decade, or I do believe that's
4 the contention of the --

5 THE WITNESS: The dominance of the singer/song-
6 writer is certainly new. I think the first singer/songwriter/
7 publisher that I've ever come across was a little player-
8 piano roll that I got at a flea market, where an Italian aria
9 was written, performed and published by the same man. That
10 was 1916.

11 COMMISSIONER COULTER: I'm speaking really of the
12 dominance.

13 THE WITNESS: Sure, of course. That's relatively
14 new. I think it was really kicked off by the Beatles. Since
15 the mid-Sixties or so.

16 COMMISSIONER COULTER: They've been dominant since
17 the mid-Sixties?

18 THE WITNESS: Oh, the Beatles became -- the Beatles
19 were certainly an outstanding singer/songwriter group, as
20 were the Rolling Stones, and both of those groups became
21 very prominent in the mid-Sixties.

22 COMMISSIONER COULTER: Okay. Now, yesterday, you
23 mentioned, in the 90 to 10 split, you mentioned that the
24 40 percent that was -- might have some attribute other than
25 the strictly composer attribute, is that correct?

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1 THE WITNESS: Yes.

2 COMMISSIONER COULTER: Do you object to the compo-
3 sers' receiving that 40 percent?

4 THE WITNESS: No.

5 COMMISSIONER COULTER: You don't? Okay, and do
6 you also agree that they legitimately got it?

7 THE WITNESS: Oh, sure.

8 COMMISSIONER COULTER: Why and how did they get it?

9 THE WITNESS: Presumably by rejecting the 50-50
10 split that they, I think, would have otherwise been offered
11 by what is commonly thought of as the conventional split that
12 exists between composers and publishers.

13 COMMISSIONER COULTER: Well, in the instance of the
14 90-to-10 split, they are the publisher, right?

15 THE WITNESS: Yes. Well, they own the firm.

16 COMMISSIONER COULTER: All right, but how did they
17 get the extra 40 percent under those terms?

18 THE WITNESS: Well, they own the copyright, and
19 the issue is, are they going to hire administration services
20 based on a percentage? And it appears that the offering of
21 10 percent is enough to induce lots of administrators to
22 come in and handle their administrative requirements, and
23 from the testimony that I gave, that appears to be a quite
24 lucrative activity, even at that 10 percent.

25 COMMISSIONER COULTER: Okay, but the overwhelming

bd-14-10

1 fact, though, is that they own the copyright.

2 THE WITNESS: Sure.

3 COMMISSIONER COULTER: You said that, according to
4 your estimates, the singer/songwriter, and I think everything
5 before us, until now, has indicated that the singer/song-
6 writer, the phenomenon that's being considered, also
7 includes the publisher -- the new hyphenates, I believe, as
8 it's called.

9 THE WITNESS: Yes.

10 COMMISSIONER COULTER: But you indicated that your
11 figures were 50 to 60 percent, is that correct? I think you
12 said that -- you estimated something along those lines.

13 THE WITNESS: The 50 to 60 percent figures are
14 a rough estimate of the fraction of the mechanical royalties
15 going to singer/songwriters, or groups that compose their
16 own material. It would be -- I believe that the way the
17 companies would have interpreted that question, would also
18 be to indicate the fraction of payments going to controlled
19 publishers.

20 COMMISSIONER COULTER: Okay. We have heard people
21 talk in terms of 50 to 80 percent, and you've said you've
22 narrowed it down to 50 to 60 percent. It's along those lines,
23 though?

24 THE WITNESS: Yeah, 50 to 60 is the weighted average
25 of the respondents. The 80 stands out for Warner.

1 COMMISSIONER COULTER: Okay, sure, but that also
2 includes controlled publishers? It's the aggregate phenomenon?

3 THE WITNESS: Right.

4 COMMISSIONER COULTER: Okay.

5 You've indicated that your concern for the profits
6 of publishers, also includes the profits of the singer/
7 songwriter-controlled publisher.

8 THE WITNESS: Yes.

9 COMMISSIONER COULTER: And I must confess that
10 I have some difficulty with that, and I'm going to explain
11 why. Mr. Yetnikoff, when addressing the issue of -- and I'm
12 going to quote. It's on page 123 of the June 24 transcript,
13 said that, "If the writer has the economic ability not to
14 have to go and sign to a publisher, then I could not advo-
15 cate reducing the writer royalties in those circumstances."

16 And Mr. Cornyn, and this is page 74 of the July
17 2 transcript, says that, "If I see someone here who is
18 100 percent artist/publisher, in terms of the content of his
19 work, then I think the question is moot" -- and I think
20 that's a word you used earlier today, "is moot as to whe-
21 ther it's a 50-50 split or a 75-25 percent split," and the --

22 THE WITNESS: I would agree, if it's 100 percent.

23 COMMISSIONER COULTER: Okay, but he's saying,
24 basically, the issue of the division, when you're dealing
25 with singer/songwriter-controlled publishers, is irrelevant.

1 THE WITNESS: Is your point that the profits
2 made by the administrative publishers should not be considered?

3 COMMISSIONER COULTER: No, that in terms of the
4 publishers' profits as to the issues raised in these pro-
5 ceedings, the amounts paid to singer/songwriters did not, at
6 least to me, seem to be related. And they constitute 50 to
7 60 percent of the royalties paid, and if my calculations are
8 correct, that would mean that half, or somewhat less, of
9 the mechanicals paid in 1979 are involved in the -- in your
10 issue of publishers' profitability.

11 And, if you apply the normal 50/50 split, that
12 would come out to somewhere around \$30 million.

13 THE WITNESS: How did you get that figure?

14 COMMISSIONER COULTER: I took \$122 million, divided
15 -- you know, cut it in half, and then cut that in half.

16 THE WITNESS: Well, I think you have the problem of
17 the definition of copyright owner, again. I don't know that
18 the wholly-owned publishing firm, the singer/songwriter
19 that is operating on 10 percent, would be collecting revenues
20 only from the output of that singer/songwriter.

21 It seems to me that, at least, the testimony I
22 gave yesterday indicates that the administrative publishers,
23 even if they're operating on only a 10 percent split,
24 would have artists, or acts, in their stable, beyond just
25 one, and would be free to do so.

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1 So I think it gets to be a very difficult issue,
2 even though -- I mean, it's a little like the holding company
3 issue. Even if Joni Mitchell owns a publishing firm, that
4 publishing firm is not restricted from owning other copyrights
5 and earning other royalties. Even if Joni Mitchell owns it.

6 COMMISSIONER COULTER: But she's getting the profit
7 from those other copyrights, then, also, is that correct?

8 THE WITNESS: Well, she may be.

9 COMMISSIONER COULTER: Well, if she controls and
10 owns it, by definition --

11 THE WITNESS: Yeah, she owns it wholly, I suppose.
12 But I don't know how one could make that choice. It would
13 seem to me that there would be singer/songwriter-owned
14 publishing firms that would have a mix of not only the flow
15 of income from that singer/songwriter, but other copyrights
16 as well. Likewise, there would be an old-line publishing
17 firm with some singer/songwriter representation, and how
18 would you draw the line? Aren't we really concerned with the
19 total flow of royalties to the owner and the composer?

20 COMMISSIONER COULTER: Well, in the case of the
21 controlled publisher, the owner is the composer.

22 THE WITNESS: Yes.

23 COMMISSIONER COULTER: And I acknowledge what you
24 have just said, but it's hard for me to perceive how you
25 divide the money there. You've indicated your own puzzlement,

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1 and I share that. But in being puzzled, I go beyond that,
2 and feel it doesn't make any difference. And I feel that --
3 and I didn't mean to catch Mr. Cornyn or Mr. Yetnikoff, but
4 I felt that their response was a very candid response, and
5 one I share, and it doesn't at all -- in saying this, I don't
6 at all mean that there aren't very serious reasons behind
7 the record industry's position in these proceedings in general.

8 I'm just saying that, on this particular issue, I
9 wonder whether the singer/songwriter-controlled publishers
10 are part of the publishing profits that you express concern
11 about. Did I make myself clear?

12 THE WITNESS: Yes.

13 COMMISSIONER COULTER: In light of that, would you
14 still insist on considering them in the same light that you
15 consider the traditional publishers?

16 THE WITNESS: Only in the sense that I'm not sure
17 how to draw the line, in terms of sampling or in terms of
18 how you would draw a distinction between a publishing firm
19 that had one artist's copyrights, or one singer/songwriter's
20 copyrights, or then two, or then three, or then five, or
21 then ten, and then perhaps copyrights that weren't produced
22 by the singer/songwriter.

23 COMMISSIONER COULTER: Well, in a somewhat different
24 vein, nevertheless, through the general presentation by the
25 record industry, there has been a concern for the amount of

1 money that the singer/composer makes, is that correct?
2 They make a lot, right?

3 THE WITNESS: Yes.

4 COMMISSIONER COULTER: On your -- page 19 of your
5 April 7 study -- you've mentioned this before -- you went
6 through this yesterday, I believe, and about 2 percent of the
7 artists' accounts produce 80 percent of the sales.

8 THE WITNESS: That is correct.

9 COMMISSIONER COULTER: I assume that the record
10 industry is grateful for those sales.

11 THE WITNESS: I would assume. I don't think they
12 could survive without them.

13 COMMISSIONER COULTER: But do they resent the
14 royalties the artists are making on those sales?

15 THE WITNESS: Resent? Is that your word?

16 COMMISSIONER COULTER: Yes, because I think that's --

17 THE WITNESS: No, I don't think so. I think the
18 concern comes from a recognition of the fact that, were
19 the mechanical rate increased, 60 percent, according to these
20 figures, of the royalties, would accrue to people who are
21 millionaires; and yet look at the effects on employment, on
22 opportunities for other songwriters, for other artists --
23 look at the effects on the consumer.

24 I suspect the record companies feel there may be
25 some effects on them, and I would imagine they simply think,

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1 my goodness, you know -- why has this happened? It's the --
2 a social policy issue, and that's why I said, at the conclu-
3 sion of my remarks, if you let the markets operate, it's
4 quite clear that these people are going to become even more
5 wealthy.

6 And I don't know how all of you feel about inject-
7 ing some social policy considerations into your delibera-
8 tions. I don't know how you will reconcile the availability
9 of sound recordings with these large gains going to a very
10 small fraction of the participants in the industry. That's
11 the --

12 COMMISSIONER COULTER: But that's not my question.
13 My question is, do you object to the very large gains going
14 to these people now?

15 THE WITNESS: Do I as a person?

16 COMMISSIONER COULTER: Well, or the record industry.
17 Do they object to it?

18 THE WITNESS: I can't really speak for the industry.

19 COMMISSIONER COULTER: You ought to speak for one
20 or the other.

21 THE WITNESS: Well, all right. As myself, I would
22 say no. Congratulations.

23 COMMISSIONER COULTER: And you don't think that
24 that's -- the amount that they're making now, violates social
25 equity?

1 THE WITNESS: I'm not a socialist in the sense
2 that people can't become millionaires, and enjoy the proceeds
3 from it. Not at all.

4 COMMISSIONER COULTER: Well, one thing that your
5 study here doesn't indicate -- and it shows that 2 percent
6 are providing 80 percent of the sales, but it doesn't show
7 actually how the money is allocated between records that
8 aren't making any money and records that are. Would you
9 acknowledge that?

10 THE WITNESS: In terms of these figures here?

11 COMMISSIONER COULTER: Yeah.

12 THE WITNESS: That is correct, I believe.

13 COMMISSIONER COULTER: Okay.

14 THE WITNESS: If I understand your question.

15 COMMISSIONER COULTER: And I'm not sure, and I
16 haven't seen where it does anyplace else in the study --

17 THE WITNESS: What would you like to know, if you
18 could --

19 COMMISSIONER COULTER: I'd like to know the amount
20 of money lost on records, period, as against the amount of
21 money earned. And that was -- I'd like to know that. I
22 simply think that that might be an indication. But let me ask
23 you another question.

24 On Exhibit 1, my understanding is that talent
25 costs and recording expenses are unrecouped expenses, and

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1 that the artist's royalty includes recouped expenses; is
2 that correct?

3 THE WITNESS: Okay. I know that you've had some
4 interest in these questions. Had we designed the question-
5 naire with your questions in mind, we would have done it some-
6 what differently.

7 If you look at the questionnaire form -- I'm
8 looking here at Section A of the questionnaire, the income
9 statement. It's the one that is very small print, because
10 of the reduction, and I want to explain what we asked for,
11 what we got, and what we presented.

12 COMMISSIONER JAMES: What page is that again?

13 THE WITNESS: It looks like that. It's question-
14 naire Section A.

15 MR. FITZPATRICK: Page 11, I think.

16 THE WITNESS: That's page 11 of the questionnaire.

side 16
17 MR. ZUCKERMAN: Dr. Kiser, so that the record is
18 clear, the instructions of the questionnaire are numbered
19 page 1 through 10. There then follows, in your April 7
20 submission, the forms, or what appears to be the forms,
21 that were distributed to the record companies, which again
22 commence numbering with page 1; and I believe that the docu-
23 ment that you referred to was page 1 of the forms which
24 follows page 10 of the instructions.

25 THE WITNESS: Thank you for the clarification. Now,

1 you will note, up at the top, in the cost of goods sold
2 section, we ask for three lines pertaining to your question.
3 We asked for A & R and studio costs, talent or recording
4 session costs, and other costs of acquiring or making a
5 master.

6 Now, the figures supplied to us by the firms, as I
7 mentioned yesterday, did not always have submissions from
8 each of those three lines -- in all of those three lines,
9 for the reasons that I gave yesterday.

10 A & R and studio costs would be departmental staff
11 costs. These would not be recoupable. They would include
12 George Butler's salary and his staff costs.

13 COMMISSIONER JAMES: His salary is not included,
14 you know.

15 THE WITNESS: His salary probably should be included
16 here, but it would not be included in what is recoupable.

17 COMMISSIONER JAMES: He testified -- I asked him
18 specifically, was his salary included in the A & R and
19 studio costs on that question? He says, no, his salary was
20 not included.

21 MR. SHERMAN: On an individual recording.

22 COMMISSIONER JAMES: All right. I stand corrected.

23 THE WITNESS: But this is the departmental cost.
24 Now, any A & R department would also have administrative
25 costs, clerical assistance and the like, and I would suppose

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1 that the firms would have reported that in G & A, so here
2 we're talking about staff costs. Talent and recording ses-
3 sion costs are recoupable costs of a recording session.
4 Some firms cannot tell us how much that is, and that's where
5 we run into trouble.

6 For example, with a superstar, there may be a flat
7 payment to the superstar, or there may be a recording budget
8 established for the superstar, which the company may not
9 maintain all that much monitoring of. It seems to me, from
10 what I've been told, that the monitoring of recording budgets
11 is done rather closely on new artists, and on emerging
12 artists, and not so closely on the superstars.

13 The superstar could spend the recording budget off-
14 site, in an additional studio or some other location, where
15 the individual expenses of how that money is spent may not be
16 tracked by the firm. That is my understanding.

17 So we, right off the bat, have payments to
18 artists that are going to recording costs, but at a level
19 we don't know, and those are reflected in the artists'
20 royalty lines. So, some of the recording costs are in the
21 line we reported, called artists' royalties.

22 Now, also, and I think this is the source of your
23 problem as far as these data go -- we asked for artists'
24 royalties to be not only the royalties earned after the artist
25 has broken even, but unrecouped advances -- kind of how much

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1 the artist is in the hole -- that's cash received by the
2 artist, but has not been earned by him, in terms of their
3 agreements; and flat payments to artists, which are rarely,
4 it's my understanding, rarely recoupable at all. These are
5 bonus payments for -- they may be for signing, they may be
6 for delivering the album, they may be just a bonus payment,
7 and we lump those together and have no way of breaking them
8 out.

9 So I can't give you a definitive figure on just
10 exactly what is recoupable and what isn't. Now, in combining
11 these expenses for the presentation -- and the only reason
12 we did that was simply to be consistent with the prior
13 reports that we have submitted -- talent costs, line 5-B,
14 went directly into line 6 on Exhibit 1. So everything in
15 Exhibit 1 on line 6 would be recoupable.

16 But line 7, recording expenses, includes not only
17 the other costs of acquiring or making a master, which
18 might be a total production deal that a label company engaged
19 in, but also the A & R and studio expense, which is unrecoup-
20 able; and that is why you can't look at line 7 and say it's
21 all recoupable.

22 COMMISSIONER COULTER: So it is more than recoup-
23 able costs?

24 THE WITNESS: That's correct.

25 COMMISSIONER COULTER: Okay.

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1 THE WITNESS: And the artists' royalties, then,
2 does include payments which are recoupable, and I don't
3 know --

4 COMMISSIONER COULTER: Well, the issue is, does
5 artists' royalties include -- well, when you say recoupable,
6 does that include also costs that have been recouped? In
7 other words, you know, you have two categories, the advances
8 and recording costs that haven't been recouped through
9 royalties, and those which have, and is it appropriate to
10 assume that your artists' royalties include --

11 THE WITNESS: No, I believe this is an area where
12 Mr. Fox would, perhaps, excel, where I'm giving you my
13 impressions and understandings. But we asked in artists'
14 royalties for artists' royalty payments, which are zero
15 until you've recouped, as is my understanding, plus unrecouped
16 advances to artists, plus flat payments. And all three are
17 in that line.

18 COMMISSIONER COULTER: Okay, are recouped expenses
19 in that line? No, let me put it this way -- are recouped
20 expenses included in talent costs or recording expenses?

21 THE WITNESS: I would think so, yes.

22 COMMISSIONER COULTER: They are? So these -- the
23 expenses in those lines include royalties that have been
24 used to offset those expenses? I mean, this is an income
25 statement. When you start with so much money at the top,

1 you've got to account for it all the way down to the bottom.

2 THE WITNESS: The talent costs -- the problem is
3 you've got a lot of accounts that are netting out one against
4 another, and they never flow to the P & L directly.

5 COMMISSIONER COULTER: But the sum has to equal
6 the total. In other words --

7 THE WITNESS: No question about it.

8 COMMISSIONER COULTER: -- because it's wholesale
9 price, and those royalties come in there, because they're
10 in one line or the other.

11 THE WITNESS: No question about it. My understanding
12 is that, as an unrecouped advance is paid, it is expensed,
13 right then and there.

14 COMMISSIONER COULTER: I understand that.

15 THE WITNESS: Okay.

16 COMMISSIONER COULTER: Because on another sheet we
17 had, they -- because the royalties offset expenses --

18 THE WITNESS: Right.

19 COMMISSIONER COULTER: And because they're account-
20 ing for royalties as a certain generic kind of money, the
21 recouped expenses were automatically included in the artists'
22 royalties. Am I making myself clear? No or yes?

23 THE WITNESS: Are you equating unrecouped advances
24 with recouped expenses?

25 COMMISSIONER COULTER: No, I'm not. You have three

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1 items here. You've got recording expenses, or unrecouped
2 recording expenses; you've got recouped recording expenses
3 through artists' royalties, and then you've got artists'
4 royalties over and above recording expenses.

5 THE WITNESS: Mm-hmm.

6 COMMISSIONER COULTER: And the exhibit we had, I,
7 includes the recouped royalties in artists' royalties,
8 simply because that's the way they were treated, because they
9 were netted out, as you say. Am I clear?

10 THE WITNESS: I understand.

11 COMMISSIONER COULTER: And my question to you is,
12 has that happened in your exhibit?

13 THE WITNESS: I'm not certain. I don't know.

14 COMMISSIONER COULTER: Okay, and I'll state really
15 why I wanted to know, is because it strikes me -- and my
16 instincts at least seemed to be confirmed by Mr. McCracken,
17 was that if you measured, if you balanced unrecouped and
18 recouped recording expenses against artists' royalties,
19 clear of recording expenses, you would have a very good finan-
20 cial measure of successful versus unsuccessful records,
21 because it's appeared during the course of this whole
22 proceeding that recording expenses are really the initial
23 hurdle. That is where the big decision is made.

24 THE WITNESS: Sure.

25 COMMISSIONER COULTER: And so -- and I was just

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1 -- you were alluding earlier to what you considered adequate
2 information, and I would think that that would be an appro-
3 priate measure to have, and I -- that's why I have gone
4 through this exercise.

5 THE WITNESS: I would urge you to pursue it with
6 Mr. Fox.

7 COMMISSIONER COULTER: But would you concede that
8 that would be a good financial measure of successful versus
9 unsuccessful records?

10 THE WITNESS: I would think so. I don't know how
11 the companies build up an individual P & L per release, or
12 what they include in that, but I'm sure that an artist
13 would have an account which would show the unrecouped advan-
14 ces, and the amount of recoupment, and a talent account
15 after the recouped versus unrecouped was netted out, that showed
16 royalties.

17 COMMISSIONER COULTER: Thank you very much.

18 MR. GREENMAN: Madam Chairman, if I could --

19 CHAIRMAN BURG: Yes?

20 MR. GREENMAN: I had asked Mr. Sherman and Mr.
21 Fitzpatrick about that material from Ms. Cranston, and I
22 wonder if they have had any answer yet?

23 MR. SHERMAN: Yes, I called and found out that they
24 are trying to develop the information, and that's as much as
25 I know right now, and I'll let you know as soon as we have

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1 anything. Also, Madam Chairman, we are serving opposing
2 counsel and the Tribunal with copies of a brief response to
3 the reply memorandum of AGAC upon the pending motion to
4 strike.

5 MR. GREENMAN: Madam Chairman, I would say that that
6 is unusually -- I would say usually the exchange of documents
7 starts with a reply. I would hope it's not necessary to
8 respond to this, but this is an unusual type of document,
9 particularly on a motion.

10 We're stuck down here without stenographic facili-
11 ties. We have had no warning this would be done, and I ask
12 that --

13 MR. FITZPATRICK: Well, I will make our -- if you
14 want to write something more, Fred, I will make our secre-
15 taries available to you.

16 MR. GREENMAN: Well, that's not much help, thank
17 you.

18 MR. FITZPATRICK: Well, I thought you said you --
19 nothing.

20 MR. SHERMAN: As I recall, there was nothing in
21 the Tribunal's order that even suggested that a reply memo-
22 randum was appropriate in this case, and you managed to
23 serve one anyway, and we are simply responding to that.

24 MR. GREENMAN: Well, I told the Tribunal ahead of
25 time that we would.

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CHAIRMAN BURG: We are adjourning until tomorrow morning at 10:00, here, in this room.

(Whereupon, at 4:45 p.m., the hearing was adjourned, to reconvene at 10:00 a.m., Thursday, July 24, 1980.)